



FINANCE COMMITTEE

13 JANUARY 2020

MATTER: DRAFT RESERVES POLICY 2020/21

To consider the amended policy for the management of the Council's financial reserves.

AUTHOR: RFO

SUPPORTING Cllr Roger Burgin -

MEMBER: Chair of Finance Committee

ITEM NO: 9 b

RECOMMENDATIONS:

The Committee is recommended to consider and approve the policy and forward it, with any further amendments, to Council for ratification.

1. LAW

The Council is required, under statute, to maintain adequate financial reserves in order to meet the needs of the organisation.

The requirement for financial reserves is acknowledged in statute. Sections 31A, 32, 42A and 43 of the Local Government Finance Act 1992 require billing and precepting authorities in England and Wales to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

There are also a range of safeguards in place that help to prevent local authorities over-committing themselves financially. These include:

- The balanced budget requirement:
 - England, sections 31A, 42A of the Local Government Finance Act 1992, as amended
- Chief finance officers' duty to report on robustness of estimates and adequacy of reserves (under section 25 of the Local Government Act 2003) when the authority is considering its budget requirement (England and Wales)
- The legislative requirement for each local authority to make arrangements for the proper administration of their financial affairs and that the proper officer has responsibility for the administration of those affairs section 151 of the Local Government Act 1972.

For best practice Penrith Town Council have referred to:
LAAP BULLETIN 99, Local Authority Reserves and Balances
July 2014

2. LINK TO COUNCIL FUNCTIONS

SUBJECT	POWER	LEGISLATION
Determination of the financial reserves which the Council estimates it will be appropriate to raise in the year for meeting its estimated future expenditure.	The Council is required to calculate a budget requirement which includes an adequate level of reserves.	Local Government Finance Act 1992, Section 50

3. LINKS TO COUNCIL PRIORITIES

The annual budget and reserves should provide resources to deliver the Council's priorities for the financial year ahead and, as appropriate, for future years.

4. REPORT DETAILS

Introduction

This report sets out the background for the determination of a reserves policy; the resulting draft contains no material changes from the 2019/20 policy.

Legal Framework

Legislation recognises that local councils require financial reserves and must take account of them in determining their precept, however there is no statutory guidance on the nature or level of funds to be set aside in reserves, unlike in other tiers of local government, where the responsible finance officer has a duty to report on the adequacy of reserves at each budget setting. All reserves are legally part of the general fund, i.e. the Council's revenue account.

Types of Reserve and Accounting Framework

Two types of reserve are relevant to the Town Council:

- The general reserve or general fund working balance, which is used to provide working capital, smooth the impact of uneven cash flows to avoid unnecessary temporary borrowing and act as a contingency in the event of sharp budgetary changes or unexpected events or emergencies. Unless allocated for a specific purpose, revenue budget underspendings and windfalls are added to the working balance. The size of the working balance should be set at a prudent level based on a risk assessment.
- Earmarked reserves, which are set aside for a specific purpose, being used to build up funds to meet known, planned or predicted spending requirements.

It used to be common for councils to build up a large number of small reserves for very specific, narrowly defined purposes; it is now more usual for fewer reserves to be set up in a way which permits their use for a range of purposes.

In accounting terms, similar to the legal position, all reserves belong to the general fund and are interchangeable, unless restricted by deed or covenant. Distinct book entries in the budget and accounts should be made to record the transactions to and from reserves. It should also be noted that the terms "reserve" and "fund" are interchangeable, and it is common to refer to each by either name.

Accounting convention does not permit the payment of interest directly to reserves. If it is decided that interest should be allocated to a reserve, the mechanism is for an equivalent contribution to be made from the revenue account (where the interest is earned) to the reserve.

Similarly, expenditure should not be charged directly to a reserve; the expenditure is accounted for in the revenue account and an equivalent amount transferred from the reserves to replenish the revenue account.

Creation and Use of Reserves

As a general and prudent rule, reserves should not be used to fund recurring expenditure (i.e. the day to day operational costs of running the Council) as this could lead to funding problems in subsequent years when the expenditure continues after the reserve has been exhausted. An exception is the general reserve, which can be used as a regulator to limit precept and council tax increases or to avoid an unacceptably high level being carried forward. Because they have a potential to affect the Council's budget, the creation of reserves and the transfers between the revenue account and those reserves should be explicit and conscious decisions taken by the Council as a whole, as should any decision to allocate interest to a reserve.

Draft Policy

The attached draft amended policy summarises the principles from this report and suggests target levels for each of the Council's reserves. One point to note is that, because of the working capital provided by the Council's earmarked reserves, it is currently possible for the general reserve to be set at a lower level than it might otherwise be. If those reserves were drawn down substantially, the risk attaching to the general reserve would increase and its target level would need to increase accordingly.

5. FINANCE IMPLICATIONS

The approach to reserves is a fundamental aspect of the financial management of the Council.

6. RISK MANAGEMENT

RISK	CONSEQUENCE	CONTROLS REQUIRED
The Council is unable to meet regular or unforeseen expenditure due to a lack of readily available funds	Overspendings leading to unwelcome curtailment of spending programmes; possible unpalatable council tax increase; potential reputational damage	An analysis of the financial risks and the maintenance of adequate reserves to meet all reasonably foreseeable eventualities

7. APPENDICES ATTACHED TO THIS REPORT

Draft Reserves Policy.

8. BACKGROUND PAPERS

Local Government Finance Act 1992 & CIPFA LAAP Bulletin 99 Reserves & Balances



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DRAFT RESERVES POLICY 2020/21

PURPOSE

The Town Council maintains two types of reserves, for differing reasons:

- a General Reserve (the General Fund working balance), which provides working capital and a buffer against financial risks; and
- earmarked reserves to meet known, planned or predicted spending requirements which have been identified specifically.

The Council acknowledges that there is a balance to be struck between holding excessive reserves raised from public monies and retaining a prudent level of funds. It will therefore take advice from its Responsible Finance Officer on the adequacy and appropriateness of its reserves, primarily when setting its revenue budget.

1. GENERAL RESERVE

This reserve represents the balance on the Council's revenue account, i.e. the account which records all its financial transactions. Unless allocated for a specific purpose, revenue budget underspendings and windfalls are added to the working balance, while overspendings are taken from the balance.

The balance provides working capital to assist the Council's cash flow and acts as a buffer against unexpected events or expenditure. The optimum level for the working balance is determined by an assessment of the Council's potential exposure to financial risks, together with a judgement of the extent to which earmarked reserves can support its cash flow on a temporary basis.

The long-term target for the reserve is to accumulate a balance equivalent to 50% of net revenue expenditure. This is to be achieved by regular annual contributions from the revenue account. The level of contributions will be determined annually, taking account of the impact on council taxpayers and the availability of earmarked reserves.

Although the Council is a relatively new organisation, it has matured quickly and has managed its risks competently. In the short term, it is appropriate to retain a lower general reserve on the strength of the Devolution Reserve until a full programme of devolution has been completed.

2. EARMARKED RESERVES

Other than any funds governed by legal conditions, the earmarking of reserves is at the discretion of the Council and monies can be moved from one to another if required. Reserves do not generally accrue interest on the investment of their funds.

In order to avoid future over-commitment, the day to day operational costs of running the Council are to be met from the revenue budget and reserves shall not be used to fund recurring expenditure.

- **Devolution Reserve:** This reserve is credited with the difference (while positive) between the council tax income equivalent to the special expenses previously levied in Penrith and the net cost of the assets transferred from Eden DC. The reserve will provide a cushion against the full cost of those assets being higher than expected, renovation and/or improvements. As significant grant payments subsidise the cost in the initial years, the risk is considerably reduced and there is no expectation that the reserve will be used significantly in that period.
- **Acquisitions Reserve:** This reserve supports a scheme of delegation for land and property, which created an allocation of £50,000 for a Capital Programme to support the activities associated with buying, surveying, legal fees, investing and managing land and property. The intention is to use these resources in the short term after which the reserve will be discontinued.

3. ESTABLISHMENT AND USE OF RESERVES

The Annex to this policy provides further details of the Council's current reserves with a target range for each one.

The establishment or closing of an earmarked reserve requires a formal decision of Council. Similarly the approval of Council is required for all contributions and transfers to reserves, and all use of reserves to fund expenditure.

Review

This policy will be subject to annual review.

CURRENT RESERVES

Reserve	Purpose	Target level
General Reserves		
General Reserve (General Fund Working Balance)	<ul style="list-style-type: none"> • Provision of working capital. • Buffer against uneven cash flows, inflationary pressures, sharp budgetary changes, unexpected events or emergencies. 	<ul style="list-style-type: none"> • Assessed on the basis of financial risks to the Council. • Long-term target to be 50% of revenue expenditure at 31 March 2024 and thereafter. • Minimum level: £100,000 • Range: £100,000 to £260,000
Earmarked Reserves		
Devolution Reserve	<ul style="list-style-type: none"> • Accumulation of funds in the early years of devolved asset transfers when grant income from Eden DC is available. • Cushion against the longer-term full costs of devolved assets being higher than expected, renovation and/or improvements. 	<ul style="list-style-type: none"> • Based on the allocation of the difference (while positive) between the income equivalent to the special expenses previously levied in Penrith via council tax and the net cost of devolved assets transferred from Eden DC • Typical Range: £nil to £156,000
Acquisitions Reserve	<ul style="list-style-type: none"> • To support the activities associated with buying, surveying, legal fees, investing and managing land and proper. 	<ul style="list-style-type: none"> • The Reserve was established with a single contribution; it is anticipated that regular contributions will not be required and that the resources will be expended in the short to medium term. • Range: £nil to £50,000

DATE OF APPROVAL: