

## Reserves Policy & Strategy 2009 - 2012

### Summary:

The Reserves Policy & Strategy presents information about the requirement for local authorities to maintain adequate financial reserves. It provides a statement on the reserves and balances currently held by the Councils within Cheshire East and the likely position at 31<sup>st</sup> March 2009. It sets out a risk based approach to the examination of the adequacy of reserves for Cheshire East Council for the period 2009 – 2012.

### 1. Relevant Information

1. The report follows guidance issued by the Chartered Institute of Public Finance & Accountancy ~ *LAAP Bulletin 55 – February 2003: Guidance Note on Local Authority Reserves and Balances*. Compliance with the guidance is recommended in the Institute's 2003 Statement on the Role of the Finance Director in Local Government.
2. The regulatory framework and role of the Chief Finance Officer are set out in Annex 1.

#### Types of Reserves

3. When reviewing medium term financial plans and preparing annual budgets Cheshire East Council must consider the establishment and maintenance of reserves. These can be held for three main purposes:
    - a **working balance** to help manage the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves
    - a **contingency** to cushion the impact of unexpected events or emergencies – this also forms part of general reserves
    - a means of building up funds, often referred to as **earmarked** reserves, to meet known or predicted liabilities
  4. **Table 1** (below) identifies the most commonly established earmarked reserves and the rationale behind why such reserves are created and maintained.
-

**Table 1: All earmarked reserves should have a clear rationale**

Category of Earmarked Reserve	Rationale
Sums set aside for major schemes, such as capital developments or asset purchases, or to fund major reorganisations	Where expenditure is planned in future accounting periods, it is prudent to build up resources in advance
Insurance reserves	Self-insurance is a mechanism used by a number of local authorities
Reserves of trading and business units	Surpluses arising from in-house trading may be retained, or may have to be retained by statute to cover potential losses in future years, or to finance capital expenditure
Reserves retained for service departmental use	Increasingly authorities have internal protocols that permit year-end surpluses at departmental level to be carried forward
School Balances	These are unspent balances of budgets delegated to individual schools

Source: CIPFA ~ LAAP Bulletin 55, 2003

5. For each reserve held by Cheshire East Council there should be a clear protocol setting out:
  - the purpose of the reserve
  - how and when the reserve can be used
  - procedures for the reserve's management and control
  - a process and timescale for review of the reserve to ensure continuing relevance and adequacy
6. When establishing reserves, Cheshire East Council needs to ensure that it complies with the Code of Practice on Local Authority Accounting in the United Kingdom and in particular the need to distinguish between reserves and provisions.

### **Assessing the Adequacy of Reserves**

7. In order to assess the adequacy of unallocated general reserves when setting the budget, the Chief Finance Officer will take account of the strategic, operational and financial risks facing the authority. Cheshire East Council will therefore adopt formal risk management processes. The Audit Commission Codes of Audit Practice make it clear that it is the responsibility
-

of the audited body to identify and address its operational and financial risks, and to develop and implement proper arrangements to manage them, including adequate and effective systems of internal control. The financial risks should be assessed in the context of the authority's overall approach to risk management.

8. There is now a requirement for local authorities to include an Annual Statement of Governance with the statement of accounts. The Chief Finance Officer needs to ensure that the authority has put in place effective arrangements for internal audit of the control environment and systems of internal control as required by professional standards.
9. Setting the level of general reserves is just one of several related decisions in the formulation of the medium term financial strategy and the budget for a particular year. Account has to be taken of the key financial assumptions underpinning the budget alongside a consideration of the authority's financial management arrangements.
10. **Table 2** (below) sets out the significant budget assumptions that are relevant when considering the adequacy of reserves that are in addition to the issue of cashflow:

**Table 2: Holding adequate reserves will depend on a number of key factors**

Budget Assumptions	Financial Standing & Management
The treatment of inflation and interest rates	The overall financial standing of the authority (level of borrowing, debt outstanding, council tax collection rates etc)
Estimates of the level and timing of capital receipts	The authority's track record in budget and financial management including the robustness of the medium term plans
The treatment of demand led pressures	The authority's capacity to manage in-year budget pressures
The treatment of planned efficiency savings/productivity gains	The strength of the financial information and reporting arrangements
The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital developments	The authority's virement and end of year procedures in relation to budget under/overspends at authority and departmental level
The availability of other funds to deal with major contingencies and the adequacy of provisions	The adequacy of the authority's insurance arrangements to cover major unforeseen risks

Source: CIPFA ~ LAAP Bulletin 55, 2003

11. These factors can only be assessed properly at local level. A considerable degree of professional judgment is required. The Chief Finance Officer may choose to express advice on the level of balances in cash and/or as percentage of budget (to aid understanding) so long as that advice is tailored to the circumstances of the authority for that particular year.
12. The advice has to be set in the context of the authority's Medium Term Financial Strategy and should not focus exclusively on short term considerations. Balancing the annual budget by drawing on general reserves may be viewed as a legitimate short term option. However, where reserves are to be deployed to finance recurrent expenditure this should be made explicit. Advice should be given on the adequacy of reserves over the lifetime of the Medium Term Financial Strategy.
13. The current guidance requires the purpose, usage and the basis of transactions of earmarked reserves to be identified clearly. It is recommended that a review of the level of earmarked reserves be undertaken as part of annual budget preparation.

## 2. General Fund Reserves

14. At 1<sup>st</sup> April 2009 Cheshire East Council is anticipated to hold general reserves totaling £15.882m. **Table 3** (below) shows the anticipated position for each local authority contributing to the reserves for Cheshire East Council in 2009.

**Table 3: Cheshire County Council Reserves have been split to reflect the position for Cheshire East only**

	<b>General Reserves</b>
<b>Contributing Authority</b>	<b>£000</b>
Cheshire CC	15,142
Macclesfield BC	2,444
Congleton BC	2,446
Crewe & Nantwich BC	1,755
Less Voluntary Redundancy Severance Costs (Forecast)	(5,905)
<b>Total at 1/4/09</b>	<b>15,882</b>

Source: County Finance February 2009

15. It is intended that transitional costs will be met from general reserves in 2009/2010, but that contributions will be made each year to replace those reserves. In addition the level of reserves needed will be assessed each year according to the risks facing the Authority. **Table 4** (below) summarises the current estimated movements in general reserves from 2009 to 2012:

**Table 4: Reserves should be restored to an adequate level by 2010**

<b>Detail of Movements</b>	<b>£000</b>	<b>£000</b>
<b>Opening General Reserves at 1/4/09</b>		<b>15,882</b>
<i>2009/10</i>		
Projected Use of Reserves		
- Transition Costs - Staff Relocation (Budget)	-1,400	
- Voluntary Redundancy - Actuarial Costs (Forecast)	-1,079	
Projected Addition to Reserves		
- Repayment of Transition Costs (Budget 2009/10)	2,750	
- Business Finance Loan Repayments	392	
- Repayment to Reserves (Forecast)	2,827	3,490
<b>Closing Balance 31/3/10</b>		<b>19,372</b>
<i>2010/11</i>		
Projected Addition to Reserves		
- Repayment of Transition Costs (MTFS)	2,750	
- Business Finance Loan Repayments	278	
- Contribution to Reserves (MTFS)	2,170	
- Repayment to Reserves (Forecast)	657	5,855
<b>Closing Balance 31/3/11</b>		<b>25,227</b>
<i>2011/12</i>		
Projected Addition to Reserves		
- Repayment of Transition Costs (MTFS)	2,750	
- Business Finance Loan Repayments	146	
- Contribution to Reserves (MTFS)	3,049	
- Repayment to Reserves (Forecast)	-222	5,723
<b>Closing Balance 31/3/12</b>		<b>30,950</b>

Source: County Finance ~ Financial Scenario February 2009

16. Work has recently been undertaken to assess the adequacy of these reserves within the context of the council's new Medium Term Financial Strategy, taking account of the relevant professional and technical guidance as detailed in this report. The outcome is detailed below.

## General Fund Reserves - Risk Assessment

17. Local Authorities have previously adopted a broad principle that General Fund Reserves would be prudent if equivalent to 5% of the net revenue budget requirement. Based on current budget estimates for 2009/2010 this would equate to £11.7m rising to £12.5m for 2011/2012.
18. The desired level of reserves is substantiated however by a more detailed risk assessment. This approach allows the council to take account of the circumstances around current structural changes and economic circumstances.
19. Risks are categorised and potential values applied to them, the actual exposure to the risk is then considered. **Table 5** (below) shows the risk areas and the level of reserves the council should retain to mitigate that risk:

**Table 5: A robust level of reserves is guided by an assessment of potential risks**

Class of Risk	Affect on budget / mitigating Action	Value of Risk Retained (£)	Class Totals (£)
<b>Health &amp; Safety</b>	Increased cost to reduce further risk of breach / Robust risk assessments	£100,000	<b>£180,000</b>
	Substantial disruption to income streams / Robust disaster recovery	£50,000	
	Cost of new advertising to regain confidence / Effective Communication Plans	£10,000	
	Additional advertising costs to attract staff / Employment options on standby	£20,000	
<b>Fire / Structural damage by flood etc</b>	Premises not operational / Robust disaster recovery plan	£100,000	<b>£125,000</b>
	Budget growth to cover premiums or self insurance costs / Good claims management	£25,000	
<b>Budget Pressures</b>	Fall of rates by 1%	£60,000	<b>£12,051,000</b>
	Up to 5% loss of income from fees & charges / prudent income targets, close in year monitoring	£1,000,000	
	Reduced cashflow / prudent cashflow projections, sound recovery strategy	£81,000	
	2% increase in spending in People Block / lean working	£936,000	
	Budgets overspend / Robust plans and monitoring of savings progress	£750,000	
	Loss of the maximum value held with one institution / strong counterparty management	£2,500,000	
	Heritable Bank Investment	£4,000,000	

	Impact on opening balances / apply prudent assumptions to opening balances	£1,800,000	
	Budgets overspend / Robust plans and monitoring of savings progress	£401,000	
	Increase in exceptional inflation items / good contract management	£523,000	
<b>ICT &amp; Security</b>	Up to 10% fine on turnover / robust security processes	£468,000	<b>£518,000</b>
	ICT service days to repair, loss of service / robust security policies and firewalls	£50,000	
<b>Industrial relations / External organisations failure</b>	Loss of income, costs of providing essential services or direct costs of resolution, reduced pay budget / emergency planning	£50,000	<b>£50,000</b>
<b>Strategic Reserve</b>	2% of Net Revenue Budget	£4,680,000	<b>£4,680,000</b>
<b>OVERALL RISKS</b>			<b>£17,604,000</b>
<b>% of Net Revenue Budget</b>			<b>7.5%</b>

Source: Cheshire East Finance Feb 2009

20. The outcome of this analysis has been to place an estimated total value on the range of risks that may arise and which are not covered by insurance. This is equivalent in total to £17.6m.
21. The reserves position for 2009/10, as detailed in Table 4 above, demonstrates the aim of Cheshire East Council to repay Transitional Costs and Voluntary Redundancy costs over the three-year planning period. The risk analysis in Table 5 demonstrates that the repayment to reserves of £2.827m could be reduced by £1.768m and the sum could be reinvested in line with the Council's priorities.
22. A further round of voluntary redundancies is now being considered and the requirement for the use of reserves in the first instance to fund the associated costs will be carefully analysed. The pay back period will be assessed for any additional cases to ensure that overall the Council can replenish reserves to the required level over a three year period.

### **Adequacy of General Reserves**

23. A duty of the Chief Finance Officer is to comment on the adequacy of financial reserves (see Annex 1). From the evidence supporting this report and with regard to the current economic climate my assessment is that reserves levels at 1<sup>st</sup> April 2009 are within tolerance levels and can be considered adequate. I also consider them to be adequate in terms of working balances.

24. The estimates contained within the Medium Term Financial Strategy are sufficiently robust to achieve the required repayment of reserves in the medium term following transition. I take this view based on the assessment of risk particularly in regard to efficiency saving assumptions within the draft 2009/2010 Budget.

### 3. Earmarked Reserves

25. At 1<sup>st</sup> April 2009 Cheshire East Council is anticipated to hold earmarked reserves to the value of £5.4m. To support key areas in the 2009/2010 Budget a further £1.096m of reserves will be earmarked by Cheshire East Council, this has already been allowed for in presenting the General Reserves position above. **Table 6** (below) therefore shows the anticipated opening balances of earmarked reserves, having allowed for balances from each contributing local authority and for further allocations by Cheshire East Council.

26. For each reserve held by a local authority there should be a clear protocol setting out:

- the purpose of the reserve
- how and when the reserve can be used
- procedures for the reserve's management and control
- a process and timescale for review of the reserve to ensure continuing relevance and adequacy

**Table 6** therefore also includes a column showing the reasons/uses for each reserve:

**Table 6: Earmarked Reserves can pump prime initiatives that may deliver future savings**

Description	Cheshire East Total £000	Reason / Use
Tatton Park - accumulated surplus	114	Tatton Park in East
Insurance Reserve	1,318	Claims experience
LPSA Reserve (continuation funding)	246	
S117 Reserve	130	Population
Education All Risks	307	Premiums paid by schools
Long Term Sickness	135	Premiums paid by schools
Building Control Surplus	329	ring-fenced surplus (could be used to offset service deficit, if applicable)
Local Development Framework	141	Service budget balance brought forward
Disturbance Payments	111	Set aside sum covering costs from relocation of staff due to office centralisation
Part-time Rangers	62	earmarked for spending on additional hours for ranger service
Lottery	10	Balance available to match fund community



		projects
Environmental Fund	8	Balance available to match fund community projects
Macclesfield Silk Heritage	10	Ongoing grants to Silk Museum
Grants Panel	71	Balance available to match fund community projects
M/S Car Park Repair	54	ringfenced for car parks, may however transfer to General Fund Working Balance
Collection Fund Discretionary Relief	142	Balance available to give discretionary relief on business rates
European Links	8	Balance available to match fund community projects
M/c Airport Partnership Fund	6	Balance available to match fund community projects
United Utilities	60	ringfenced for outstanding account, may be required in 08/09
Childcare Vouchers	1	balance on account, may transfer to GF working balance
Job Evaluation	300	intended to be used to offset final protected pay in 2009/10
Environmental Warranties	188	self-insurance for possible claims from Cheshire Peaks and Plains
Benefits appeals reserve	400	relates to Alternative Futures case, still needs to be reserved
Building Control	376	ring-fenced surplus (could be used to offset service deficit, if applicable)
Business development land acquisition (LABGI-funded)	250	approved for capital project financing
Crewe town centre development transitional shortfall (LABGI-funded)	219	earmarked to cover costs and income shortfalls (car parks etc.) during Crewe town centre re-development
Capital investment reserve (LABGI-funded)	164	approved for financing various capital projects
Single status/ job evaluation	150	intended to be used to offset final protected pay in 2009/10
Markets - Disturbance costs/ new stalls (LABGI-funded)	150	intended for spending during and after Crewe town centre re-development
Economic & physical development projects (LABGI-funded)	60	approved for strategy development/ business promotion initiatives
Queens Park - Boats/ equipment/ facilities	52	intended to purchase items following completion of Park restoration
Insurance reserve	50	to be assimilated into CE self-insurance reserve
Safer Communities - PCSOs	46	earmarked for PCSOs/ ASB Co-ordinator commitments
Crewe Business Park - Marketing Office rent	46	approved for repairs/ costs in the event of transfer of management of Park
Cumberland pitch renewal (CNBC share)	31	following major investment, using annual additional surplus to build a fund to renew in future
Community Wardens - Fixed penalties income	24	ring-fenced for improving cleanliness of public spaces
Safer Communities - Alley gates maintenance	20	intended for maintenance of gates, following capital-funded installations

Treasury - Temporary staff	20	will be used to cover temp staff for closure of 2008/09 Accounts
Environmental Protection Act	14	intended for environmental emergency response situations
<b>Total</b>	<b>5,823</b>	
<b>Further Reserves to be created for Cheshire East*</b>		
Economic Development	650	To provide capacity for statutory and development requirements in 2009/2010
Community Safety	109	To provide additional capacity in 2009/2010, which will enable invest to save options to be adapted for future years
Local Development Framework	100	To provide additional capacity in 2009/2010 only
Trading Standards	60	To protect against possible shortfall in essential service during 2009/2010
Customer Access	177	To maintain service levels in 2009/2010 and allow development of invest to save options
<b>Total</b>	<b>1,096</b>	

Source: Cheshire County & District Finance Jan 2009

\*it should be noted that these additional earmarked reserves have been allowed for when stating the General Reserves position for the 2009/2010 Budget

27. Earmarked reserves have the effect of transferring the tax burden across financial years as current taxpayers' funds are being used to support future years' spending. It is therefore recommended that the Council's earmarked reserves are subject to annual review as part of the budget-setting process to ensure that they are still appropriate, relevant and adequate for the intended purpose.

#### Background Papers:

CIPFA, Local Authority Accounting Panel: Bulletin 55, Local Authority Reserves & Balances (2003)

General Fund Reserves ~ Risk Assessment Working Papers 2008

Final Accounts:

Cheshire County Council  
Congleton Borough Council  
Crewe & Nantwich Borough Council  
Macclesfield Borough Council

**Lisa Quinn**  
**Borough Treasurer & Head of Assets (Chief Finance Officer)**

---

### Annex 1

#### Protocol & Controls

##### **The Existing Legislative/Regulatory Framework**

Sections 32 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 three significant safeguards in place that militate against local authorities over-committing themselves financially:

1. The balanced budget requirement
2. Chief Finance Officers' S114 powers
3. The External Auditor's responsibility to review and report on financial standing.

The balanced budget requirement is reinforced by section 114 of the Local Government Finance Act 1988 which requires the Chief Finance Officer to report to all the authority's councillors if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that the authority will not have the resources to meet its expenditure in a particular financial year. The issue of a section 114 notice cannot be taken lightly and has serious operational implications. The authority's full council must meet within 21 days to consider the S114 notice and during that period the authority is prohibited from entering into new agreements involving the incurring of expenditure.

While it is primarily the responsibility of the local authority and its Chief Finance Officer to maintain a sound financial position, External Auditors have a responsibility to review the arrangements in place to ensure that financial standing is soundly based. In the course of their duties External Auditors review and report on the level of reserves taking into account their local knowledge of the authority's financial performance over a period of time. However, it is not the responsibility of auditors to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general.

##### **The Role of the Chief Finance Officer**

It is the responsibility of the Chief Finance Officer to advise local authorities about the level of reserves that they should hold and to ensure that there are clear protocols for their establishment and use. There is no statutory minimum.

Local authorities, on the advice of their Chief Finance Officers, are required to make their own judgements on the level of reserves taking into account all the relevant local circumstances. Such circumstances vary. A well-managed authority, for example, with a prudent approach to budgeting should be able to operate with a

---

relatively low level of general reserves. There is a broad range within which authorities might reasonably operate depending on their particular circumstances.

### **Good Governance**

It is important that Members take responsibility for ensuring the adequacy of reserves and provisions when they set the budget. CIPFA recommend that the respective roles of officers and Councillors in relation to reserves should be codified locally and given due recognition in the Constitutions. This codification should:

- state which council bodies are empowered to establish reserves
- set out the responsibilities of the Chief Finance Officer and Councillor – or group of Councillors – responsible for finance
- specify the reporting arrangements

### **A New Reporting Framework**

The Chief Finance Officer has a fiduciary duty to local taxpayers, and must be satisfied that the decisions taken on balances and reserves represent proper stewardship of public funds.

The level and utilisation of reserves will be determined formally by the Council, informed by the advice and judgement of the Chief Finance Officer. To enable the Council to reach its decision, the Chief Finance Officer should report the factors that influenced his or her judgement and ensure that the advice given is recorded formally. Where the advice is not accepted this should be recorded formally in the minutes of the council meeting.

### **CIPFA recommended that:**

The budget report to the Council should include a statement showing the estimated opening general reserve fund balance for the year ahead, the addition to/withdrawal from balances, and the estimated end of year balance. Reference should be made as to the extent to which such reserves are to be used to finance recurrent expenditure this should be accompanied by a statement from the Chief Finance Officer on the adequacy of the general reserves and provisions in respect of the forthcoming financial year and the authority's medium term financial strategy a statement reporting on the annual review of earmarked reserves should also be made at the same time to the Council. The review itself should be undertaken as part of the budget preparation process. The statement should list the various earmarked reserves, the purposes for which they are held and provide advice on the appropriate levels. It should also show the estimated opening balances for the year, planned additions/withdrawals and the estimated closing balances.

---