

**DRAFT**

# **Reserves Strategy**

## Executive Summary

1. Cheshire East Council is maintaining adequate reserves for two main purposes:
  1. To protect against risk, and;
  2. To support investment and transformation
2. This strategy reflects how these two purposes are intrinsically linked as financial risks will reduce through appropriate investment in schemes that will generate sustainable returns.
3. The most significant risks to the Council's financial strategy are:
  - a. COVID-19 costs exceeding available grants
  - b. The review of Local Government financial models reduces grant income to the Council (such as Fairer Funding / Business Rate Retention).
  - c. Demand and complexity in services increases at rates in excess of current forecasts.
  - d. Economic factors, such as Inflation and Interest Rates, negatively impact on expenditure and income.
  - e. An end to the current accounting override for negative reserves linked to the Dedicated Schools Grant
4. The most significant single elements of the Council's budget therefore have named reserves to manage these risks. This includes reserves to managing Capital Financing, Collection Fund, MTFS annual variations as well as for General purposes. The exception is that there is no specific reserve to manage the emerging deficits within DSG.
5. The Reserves Strategy presents information about the requirements to maintain financial reserves and provides statements on the types of reserves and current and predicted balances.
6. The Strategy is revised annually, in line with the process to determine the Council's Budget and sets out a clear purpose for the holding of reserves, using risk assessments and setting out principles for the management of balances in the medium term.
7. Cheshire East Council's Reserve Strategy was last approved at Council on 17<sup>th</sup> February 2021.
8. The financial review process informs the Council's thinking on reserves and an updated Reserves Strategy for 2022-26 is being reported to Council in February 2022.
9. This strategy represents the latest position, following a review of the balances previously held, to ensure they meet the needs of Cheshire East Council.
10. Additional detailed analysis of trends within the Council's finances is provided in the Council's [Value for Money](#) publication demonstrating the sound financial position of the Council.

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# 1. Introduction

## Types of Reserves

11. When reviewing medium term financial plans and preparing annual budgets the Council considers the establishment and maintenance of reserves. Two types of Revenue Reserves will be held:

### General Reserves (see Section 2)

12. This represents the non-ring-fenced balance of Council funds. There are two main purposes of general reserves: firstly, to operate as a working balance to help manage the impact of uneven cash flows and avoid unnecessary temporary borrowing; and secondly to provide a contingency to cushion the impact of emerging events or genuine emergencies. The target level of reserves retained will be risk based. General Reserves must be adequate and will increase and decrease as follows:
13. Increasing General Reserves
  - Planned repayment as set out in the Medium-Term Financial Strategy, usually to recover to an adequate level in relation to a detailed risk assessment, or to prepare in advance for future risks or investment.
  - Allocation of an operating surplus at the close of the financial year.
14. Decreasing General Reserves
  - Planned draw-down of reserves to create investment, and to counteract the possibility of over-taxing in any financial year.

- Allocation of an operating deficit at the close of the financial year.

### Earmarked Reserves (see Section 3)

15. These provide a means of building up funds, for use in a later financial year, to meet known or predicted policy initiatives. Discipline is required around setting up and maintaining earmarked reserves and this Strategy sets out the Council's approach to this. Earmarked reserves will increase through decisions of the Council and will decrease as they are spent on specific intended purposes.

### Assessing the Adequacy of Reserves

16. In order to assess the adequacy of unallocated general reserves when setting the budget, the Section 151 Officer will take account of the strategic, operational and financial risks facing the Authority. The 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 will be assessed in the context of the Authority's overall approach to risk management.
17. There is a requirement for local authorities to include an Annual Statement of Governance with the Statement of Accounts. The Section 151 Officer ensures 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.

18. 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 will also be taken of the key financial assumptions underpinning the budget alongside a consideration of the Authority's financial management arrangements.
19. **Table 1** sets out the significant budget assumptions that are relevant when considering the adequacy of reserves, in addition to the issue of cashflow.
20. These factors can only be assessed properly at a local level. A considerable degree of professional judgment is required. The Section 151 Officer may choose to express advice on the level of balances in cash and / or as a percentage of budget (to aid understanding), so long as that advice is tailored to the circumstances of the Authority for that particular year.
21. Advice will be set in the context of the Authority's process to manage medium term financial stability and not focus on short term considerations, although balancing the annual budget by drawing on general reserves may be a legitimate short-term option. However, where reserves are to be deployed to finance recurrent expenditure this should be made explicit and will occur only to pump prime investment and not to regularly support such costs. Advice will be given on the adequacy of reserves over the lifetime of the Medium-Term Financial Strategy.

**Table 1:**

Holding adequate reserves will depend on a number of key factors  
Budget Assumptions

- The treatment of inflation and interest rates
- Estimates of the level and timing of capital receipts
- The treatment of demand led pressures
- The treatment of planned efficiency savings / productivity gains
- The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital developments
- The availability of other funds to deal with major contingencies and the adequacy of provisions

#### Financial Standing and management

- The overall financial standing of the Authority (including: level of borrowing, debt outstanding and council tax collection rates)
- The Authority's track record in budget and financial management including the robustness of the medium-term plans
- The Authority's capacity to manage in-year budget pressures
- The strength of the financial information and reporting arrangements
- The Authority's virement and end of year procedures in relation to budget under / overspends at authority and service level
- The adequacy of the Authority's insurance arrangements to cover major unforeseen risks

Source: CIPFA – LAAP Bulletin 55, 2003

22. The current guidance requires the purpose, usage and the basis of transactions of earmarked reserves to be identified clearly. A review of the levels of earmarked reserves will be undertaken as part of annual budget preparation.

## 2. General Fund Reserves (Revenue)

### Purposes

23. The purpose of general reserves is to minimise the possible financial impacts to the Authority from:
- Emergencies
  - In-year emerging financial issues
  - Reacting to investment opportunities
24. The Finance Procedure Rules set the parameters for access to general reserves.
25. The in-year use of general reserves requires approval within the limits set by the Constitution and must not be used for any level of recurring spending unless that spending will be included in revenue budgets in the following financial year or a suitable payback period is agreed in advance.
26. In all cases the use of reserves should be approved by the Section 151 Officer.

### Opening Balances

27. The Council currently holds general reserves as at 1<sup>st</sup> April 2021 of £11.5m.

28. Following a review of the risk assessed minimum level requirement general reserves will remain at £11.5m.
29. At 1<sup>st</sup> April 2022, it is anticipated that the Council will hold general reserves of £11.5m, as calculated in **Table 2**.

Table 2	Estimated Balance
	1 <sup>st</sup> April 2022 £m
Amount of General Fund Balance available for new expenditure	11.5
The impact of performance against the 2021/22 Revenue Budget	0.0
	11.5

### Estimated Movement in Reserves (2021/22 onwards)

30. **Table 3** summarises the current estimated movements in general reserves from 2022 to 2026.
31. The level of reserves needed is assessed each year according to the risks facing the Authority (see Risk Assessment overleaf).
32. During 2019 CIPFA published a financial management code designed to support the Local Government sector as it faces continued financial challenge, the Code recognises 'that using

the financial reserves to finance a deficit or to avoid difficult decisions around spending cuts provides temporary relief, but is *not sustainable in the long term.*'

33. This guidance from CIPFA follows the National Audit Office (NAO) report on financial sustainability in local authorities. This indicated that there is a heightened risk of more Council's over the coming years falling into special measures as a result of not reconciling the pressure on budgets.
34. The reserves position will continue to be monitored as part of the in-year review of financial performance and risk management. A level of £11.5m remains adequate assuming budget proposals are achieved and risks appropriately managed. General reserves of £11.5m as a proportion of net revenue expenditure is 3.6%.

<b>Table 3:</b> The level of reserves will be maintained in the medium term	2021/22	2022/23	2023/24	2024/25	2025/26
	£m	£m	£m	£m	£m
Estimated Balance @ 1 <sup>st</sup> April	11.5	11.5	11.5	11.5	11.5
Estimated Impact of Spending	0.0	0.0	0.0	0.0	0.0
Planned Contribution	0.0	0.0	0.6	0.6	0.0
<b>Forecast General Reserves @ 31<sup>st</sup> March</b>	<b>11.5</b>	<b>11.5</b>	<b>11.5</b>	<b>11.5</b>	<b>11.5</b>
Risk Assessed Minimum Level	11.5	11.5	11.5	11.5	11.5

Source: Cheshire East Finance

35. The level at which reserves are set for 2022/23, reflects the aim of Cheshire East Council to match the Risk Assessed Minimum Level, ensuring reserves are adequate, and provide sufficient flexibility to manage short term cashflow.

### General Fund Reserves – Risk Assessment

36. The risks facing each local area will vary. In the case of Cheshire East, the impact of rising demand for services, the economic climate, COVID-19, emerging Government policies (particularly in relation to business rates), and pressure on public services to reduce overall expenditure are relevant, and these present the potential for significant emerging risk.

37. The minimum target level of reserves is quantified by a detailed risk assessment. This approach allows the Council to take account of local circumstances and the impact of economic forecasts.
38. Where specific financial liability has not been established, or where outcomes from emerging pressures cannot be detailed, the Council will assume an appropriate level of risk. This reduces the possibility that the Council will be exposed to excessive financial pressure in a single year thereby smoothing the impact on citizens.
39. Risks are categorised, and potential values are applied to them. This presents the potential exposure to financial risk. **Table 4** shows the risk areas and the level of reserves Cheshire East Council should retain to mitigate that risk. In each case the value of the risk retained has been calculated as a percentage of the potential impact. The percentage is based on the likelihood of the risk actually achieving that total impact in any year.
40. The Risk Assessment for 2022/23 provides for the Minimum Level to be set at £11.5m. This is considered an adequate overall target for reserves at 3.6% of the net budget.
- Some savings targets may need to be re-phased or revised following more detailed appraisal or consultation work.
  - Maintained schools are predicting significant deficit budget positions in their three-year forecasts as a result of staffing
41. It is also possible that a number of events could happen in a single year and the Council could be exposed to new unidentified risks. For this reason, the analysis also contains a
- Strategic Reserve calculated as a percentage of gross expenditure (in this case 0.8%).
42. Risks will be included and managed using the following basic principles:
- a. The risk may impact within the medium term.
  - b. Risks are potential one-off events.
  - c. The risk will have genuine financial consequences beyond insurance cover.
  - d. Mitigating actions will be in place to minimise the potential requirement for financial support.
  - e. If a risk becomes 100% likely it will be allocated to earmarked reserves or included within appropriate Revenue Budget estimates.
  - f. Emerging risks will be addressed from an in-year surplus or virement before any request to allocate general reserves.

Table 4: A robust level of reserves is guided by an assessment of potential risks

[illegible]



43. 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 £11.5m.

44. It should be noted that these risks reflect the net effect of issues relating to sustainable performance against the 2022/23 Revenue Budget. The key factors are:

- The capacity of the organisation to deliver proposed growth or achieve the proposed level of savings entirely.
- Potential underachievement of cost reduction targets following consultation processes.
- Demand for services rising above estimated trends.
- Changes to Government settlements.

therefore be against the promotion of local autonomy and would conflict with the financial freedoms offered to local authorities.

47. The Secretary of State in England has reserve powers to specify in regulations a statutory minimum level of reserves that will be used if authorities fail to remedy deficiencies or run down reserves against the advice of the Section 151 Officer. The Government has undertaken to apply this only to individual authorities in the circumstances where an authority does not act prudently and disregards the advice of its Section 151 Officer.

### Adequacy of General Reserves

45. The Local Government Finance Act 1988 and 1992 and the Local Government Act 2003 emphasise the importance of sound and effective financial management in England and Wales by the statutory duty of the Section 151 Officer to report to the authority, at the time the budget is considered and the council tax set, on the robustness of the budget estimates and the adequacy of financial reserves.

46. CIPFA and the Local Authority Accounting Panel consider that local authorities should establish reserves including the level of those reserves based on the advice of their Section 151 Officer. There is no statutory or recommended minimum level of reserves as they are established by the Section 151 officer making judgements on such matters taking into account all the relevant known and expected local circumstances. Imposing a statutory minimum would

### 3. Earmarked Reserves (Revenue)

#### Purpose

48. The purpose of an earmarked reserve is:
  - To prevent an uneven impact from policy options, by allowing balances to be set aside for future year expenditure.
  - To set aside amounts for projects which extend beyond one year.
49. Once Earmarked reserves have been established by Cheshire East Council it is the responsibility of Chief Officers, in consultation with the Section 151 Officer, to ensure balances are spent in line with their purpose.
50. **Table 5** identifies the most commonly established earmarked reserves and the rationale behind why such reserves are created and maintained.
51. **For** each earmarked reserve held by Cheshire East Council there will 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,
  - clear indication of payback periods and approach (if applicable).

**Table 5: 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	An Insurance Fund has been established to meet the potential costs of insurance excesses arising from claims in respect of fire and consequential loss, public and employer liability, and vehicles relating to both Cheshire East Council and the former Cheshire County Council.
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

52. When establishing reserves, Cheshire East Council will 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.
53. The protocol for Cheshire East Council earmarked reserves is set out below. The Section 151 Officer will monitor adherence to these protocols. Details of each reserve will be held to demonstrate compliance with the protocols.
54. Earmarked Reserves will be:
- Set up by Full Council, on recommendation by the Section 151 Officer,
  - Supported by a business case,
  - Normally held for a maximum of 3 years, except where the business case justifies a longer retention,
  - Reviewed at least annually by the Full Council.
  - Aligned to Committee budgets by the Finance Sub-Committee, and subsequently reviewed regularly by the relevant Committee.
55. Services may also carry forward balances in accordance with Financial Procedure Rules.
56. 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 Cheshire East Council's earmarked reserves are subject to annual review, at least as part of the budget setting process, to ensure that they are still appropriate, relevant and adequate for the intended purpose.
57. Service Committees will receive regularly reports to monitor spending, benefits and current levels of aligned reserves.
58. The 2021/22 position on earmarked reserves is reported in the 2021/22 Financial Review Report, as part of the 1<sup>st</sup> December, Finance Sub Committee report.
59. All reserves will be subject to revised business cases to ensure that only the required levels are carried over into 2022/23.
60. At 1<sup>st</sup> April 2022, it is anticipated that balances on existing earmarked reserves held by Cheshire East Council will be £59.3m. It is estimated that balances will reduce by £14.4m by the end of 2022/23. **Table 6** (overleaf) shows the position on each earmarked reserve.
61. The opening balances also includes COVID-19 grants in the region of £4.7m, which are expected to be fully utilized in 2022/23.

**Table 6**

Name of Reserve	Opening Balance 1st April 2022 £000	Forecast Movement in Reserves 2022/23 £000	Forecast Closing Balance 31st March 2023 £000	Notes
<b>Corporate Policy Committee</b>				
Corporate Directorate	1,285	(155)	1,130	To support a number of widespread projects within the Corporate Directorate
Collection Fund Management	16,478	(3,346)	13,132	To manage cash flow implications as part of the Business Rates Retention Scheme. Includes liabilities that will not be paid until future years.
Financing Reserve	7,098	(914)	6,184	To provide for financing of capital schemes, other projects and initiatives.
Brighter Future Transformation Programme	2,050	0	2,050	To fund the Council's four year transformation programme and its five outcomes of Culture; Estates and ICT systems; Customer Experience, Commercial Approach and Governance.
Pay Structure (M Grade Review)	366	(184)	182	To fund ongoing changes to pay structure.
Insurance Reserve - Cheshire East & Cheshire County Fund	6,048	158	6,206	To settle insurance claims and manage excess costs.
Other Useable reserves (<£500,000 in value)	278	(27)	251	Includes General Elections & HR programme
MTFS Reserve	7,881	0	7,881	To support the financial strategy and risk management.
Revenue Grants	2,175	(905)	1,270	Unspent specific use grant carried forward into 2022/23.
Revenue Grants - Covid-19	4,653	(4,653)	0	Covid (Unringfenced) reserve carried forward into 2022/23
<b>Adults and Health Committee</b>				
Adults Directorate	1,020	0	1,020	To support a number of widespread projects within the Adults, Health and Integration Directorate.
DOL's Assessments	300	(300)	0	Reserve required due to delays in closure and will run across two years up to 2022/23.
PFI Equalisation - Extra Care Housing	2,715	80	2,795	Surplus grant set aside to meet future payments on existing PFI contract which commenced in January 2009.
NHB Community Grants Staffing	132	0	132	To support administrative staffing costs in relation to Central Government's New Homes Bonus guidance for community projects.
Public Health	2,540	(1,270)	1,270	Ring-fenced underspend to be invested in areas to improve performance against key targets. Including the creation of an innovation fund to support partners to deliver initiatives that tackle key health issues. Anticipated that the carry forward ringfenced grant will be spent across 2022/23 and 2023/24.

Name of Reserve	Opening Balance 1st April 2022 £000	Forecast Movement in Reserves 2022/23 £000	Forecast Closing Balance 31st March 2023 £000	Notes
<b>Children and Families Committee</b>				
Childrens Directorate	422	0	422	To support a number of widespread projects within the Children and Families Directorate
Transformation Funding	750	(750)	0	Service is planning to spend half of 1.5m in 2021/22 and half in 2022/23.
Other Useable reserves (<£500,000 in value)	135	(49)	86	Includes Domestic Abuse Partnership; Skills & Lifelong Learning; School Organisation & Capital Service
<b>Highways and Transport Committee</b>				
Other Useable reserves (<£500,000 in value)	973	(922)	51	Includes: Flood Recovery Works; Well Managed Highway Infrastructure Delay; Highways Procurement Proj; HS2; Parking Pay and Display Machines / Parking Studies
<b>Economy and Growth Committee</b>				
Place Directorate	899	(339)	560	To support a number of widespread projects within the Place Directorate
Investment (Sustainability)	490	(490)	0	To support investment that can increase longer term financial independence and stability of the Council.
Legal Proceedings	110	(110)	0	To enable legal proceedings on land and property matters.
<b>Environment and Communities Committee</b>				
Strategic Planning	443	(215)	228	To meet costs associated with the Local Plan - site allocations and minerals and waste DPD
Other Useable reserves (<£500,000 in value)	54	(54)	0	Includes: Air Quality; Licensing Enforcement
<b>TOTAL</b>	<b>59,295</b>	<b>(14,445)</b>	<b>44,850</b>	

## 4. Capital Reserves

- 62. Capital receipts received in-year are fully applied to finance the capital programme. A small amount of capital receipts are held in reserve to cover future commitments where receipts are to be used flexibly to fund transformational projects.
- 63. Where revenue contributions are used to finance capital expenditure these will be held in reserve until such time as the expenditure is incurred.

## 5. Reserves Strategy Conclusion

- 64. Overall, Cheshire East Council is establishing reserves that match the minimum risk levels while retaining flexibility to react to investment opportunities. This approach can be supported during the medium term based on recent performance against budget.
- 65. This recognises local issues and allows the Section 151 Officer to report favourably on the adequacy of reserves. The full report of the S.151 Officer is provided on Page X of the MTFS Full Report.
- 66. The maintenance of protocols around the use of balances improves control and increases openness in financial reporting and management. This approach assists with financial planning and increases understanding of Cheshire East Council's financial position. Reserves positions will continue to be reviewed throughout the financial year.

## Background Papers

- 67. General Fund Reserves – Risk Assessment Working Papers 2021.  
CIPFA Local Authority Accounting Panel: Bulletin 55, Local Authority Reserves and Balances (2003).  
CIPFA Financial Management Code 2019  
Cheshire East Draft Statement of Accounts 2020/21

