

## TORBAY COUNCIL

Report No: **451/2005**

Title: **Review of Reserves 2006/07**

To: Executive on 11th October 2005

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### **1. Purpose**

- 1.1 To review the Council's Reserves as part of the 2006/2007 budget setting process

### **2. Relationship to Corporate Priorities**

- 2.1 The level of reserves is core to the delivery of all the Council's priorities.

### **3. Recommendation**

- 3.1 That Members review the Council's Reserves.
- 3.2 That Members approve the Council's policy for reserves as detailed in paragraph 8 of this report.
- 3.3 That Overview and Scrutiny Board also be invited to review this analysis of the Council's Reserves and report back during the budget round any new proposals.

### **4. Reason for Recommendation(s)**

- 4.1 A Review of Reserves is a key part of the Council's budget setting process.

### **5. Key Risks associated with the Recommendation(s)**

- 5.1 It is important that the issues raised in this report are considered by Members and appropriate action is taken, where necessary, to ensure that the Council has adequate reserves in the short and medium term. Failure to consider the issues raised within this report and taking appropriate action could result in the Council having insufficient reserves that could adversely impact on the revenue budget.
- 5.2 The "x" in the matrix below denotes where the author has assessed the level of final risk to fall.

Likelihood	6	6	12	18	24
	5	5	10	15	20
	4	4	8	12	16
	3	3	6	9	12
	2	2	4	X6	8
	1	1	2	3	4
		1	2	3	4
		Impact			



Low  
risk



Intermediate  
risk



High risk

## **6. Alternative Options.**

- 6.1 Members can propose an alternative treatment of reserve balances subject to further risk assessment.

## **7. Background**

### **7.1 Legislative Requirements.**

- 7.2 The Local Government Act 2003 introduced the responsibility for a Council's Chief Finance Officer to report on the adequacy of Council reserves as part of the budget setting process.

- 7.3 This requirement is in addition to the requirements of the Local Government Finance Act 1992, which requires Councils to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

- 7.4 To support these requirements CIPFA issued the following guidance: - LAAP Bulletin 55 - Guidance Note on Local Authority Reserves and Balances. This advises Chief Officers and Councils in their use of reserves and is considered to represent good financial management.

### **7.5 Why Hold Reserves?**

- 7.6 Torbay Council, like most Councils, holds reserves for two main purposes

- a) A contingency to cover the impact of unexpected events or emergency. This is often known as a Council's General Fund Reserve.
- b) A means of building up funds often referred to as Earmarked Reserves, to meet known or predicted liabilities. These Earmarked Reserves could include:

Sums set aside for known or anticipated liabilities.

Sums set aside for major schemes.

Insurance reserves.

Trading reserves (Harbours & Operations).

Reserves retained for Service Department use.

School balances.

Council Tax Collection Fund Balances.

### **7.7 Purpose of a Review of Reserves.**

- 7.8 This annual review should form part of a Council's Risk Management process. If a reserve is assessed not to be adequate, an appropriate contribution from future year's revenue budgets should be planned for, conversely if a reserve is assessed as over provided, the surplus can be used as part of future year budget funding.

## 8 Policy for Reserves

- 8.1 It is considered good practice for Councils to agree a policy for their reserves. Due to the wide range of earmarked reserves for a range of service issues, any policy will therefore be general in its nature. It is suggested that the following policies apply to Torbay's Reserves.

### Earmarked Reserves:

"Torbay Council will hold earmarked reserves to meet known or specified liabilities. The purpose of each reserve will be clearly stated when established along with a suggested target range for the balance on the reserve. Each reserve will be allocated to the responsibility of a service manager who will at least twice a year review the reserve for both relevance and adequacy. If a Reserve is assessed as not required or a change in use is requested this will be reported in the next Budget Monitoring Report to Executive".

### General Fund Reserve:

"The Council will maintain a General Fund Reserve as a contingency to cover the impact of unexpected events or emergency. The Council will at least annually review the reserve and assess the target range for the balance on this reserve in light of the Council's overall financial position".

## 9 Review of Reserves 2005/06

### 9.1 Overview

- 9.1 As at 31/03/2005 Torbay Council's reserves were as follows:-

	<b>2004/05</b>	2003/04	% Change
	<b>£m</b>	£m	
General Fund Reserve	2.7	2.3	17%
Insurance Reserve	3.1	2.2	40%
Schools Reserves	2.9	2.2	32%
Trading Reserves	1.8	1.8	0%
Earmarked Reserves	9.4	7.2	30%
Collection Fund Reserve	1.0	0.6	67%
<b>Total Reserves</b>	<b>20.9</b>	16.3	28%

- 9.2 A list of the Council's Reserves as at 31/03/2005 as reported in the Council's Statement of Accounts 2004/2005, (now audited) is attached at Appendix 1.
- 9.3 The table in 9.1 shows that the total reserves held by the Council increased by 28% during 2004/05. The General Fund Reserve increased by £413,000 due to the net underspend on the Council's revenue budget in 2004/05. This was a welcome boost to increase the level of General Fund Reserve held which will help meet ongoing concerns over the level of reserve held in relation to the overall Council budget.

- 9.4 A list of all Council Reserves is attached at Appendix 2. Each page shows details about each reserve, including the reason/purpose of the reserve, how and when the reserve can be used and the process for retention of each reserve to ensure continuing relevance and adequacy. (The balance on each reserve on these sheets is at 05/09/05). Each reserve has been assessed by the Service Manager and their finance manager for its estimated balance as at 31<sup>st</sup> March 2006 and for the estimated additions or withdrawals from the reserve during 2006/07. This is included in the table at Appendix 1. This table is before recommendations arising from this report.
- 9.5 In addition each of the pages show an assessment of the current minimum level of the reserve and, where applicable, an acceptable range for each reserve balance. A number of these have indicated a surplus balance or that the minimum level of reserve could be set at a higher level. These balances have been assessed using a risk analysis and therefore it would be hard to justify a lower than minimum balance.
- 9.6 The External Auditor will be looking closely at the action of the Council when it applies these reserves and will be highly critical of the Council if it uses these funds to sustain ongoing revenue expenditure rather than "one off" items.
- 9.7 Earmarked Reserves
- 9.8 For the Earmarked Reserves where no specific comment has been made below, it is recommended that no changes are made. Specific comments on the following reserves are listed below along with any recommendations.
- 9.9 **Insurance Reserve:**
- Council in August 2004, following the First Secretary of State's decision to cap Torbay Council, recommended that the resulting shortfall in funding of £614,000 be met from earmarked reserves. The Insurance reserve was utilised for this purpose with the monies replaced over 2005/06 and 2006/07. However the Insurance reserve was increased despite the temporary withdrawal to fund the capping issue. This increase reflected the usual timing delay in claims arising and the transfer of monies to this reserve from the Review of Reserves 2005/06. The balance of £3.062 million as at 31<sup>st</sup> March 2005 reflects the position after the utilisation of £0.614 million needed to meet the cuts required by capping. Thus the true balance is approximately £3.676 million which will cover the specified amounts for Municipal Mutual Insurance (MMI) - both the Torbay Council and Devon County Council liabilities, residual Devon County Council liability relating to services transferred to Torbay in 1998 and monies to cover known and potential claims relating to Torbay Council.
- 9.10 The Council has in the last few years witnessed a rise in the value of public liability claims which it has to cover from the reserve. The Council's actuary has now advised that the rise in the value of claims has now levelled out therefore the Council will not need to increase its contribution to the insurance fund beyond the currently budgeted levels for claims.
- 9.11 As a by product of this advice the Medium Term Financial Plan now shows a reduction in the amount being planned to be put into the fund over the next three years.

#### 9.12 **Harbour Reserves**

Although the balances held in these two accounts are greater than the recommended minimum level of balance, it is not recommended that these balances be reduced given the major works being proposed in the Harbours over the next few years and the constant risk of storm damage to the harbour estate.

#### 9.13 **Childrens Services' Early Retirement Reserve**

This Reserve held within Children's Services for schools is fully committed for 2005/06. Childrens' Services budget to make an annual contribution of £93,000 to this Reserve, however service managers will include any suggested increase to replenish this reserve as a development item during the 2006/07 budget process.

#### 9.13 **School Reserves**

The level of overall school funds has increased by 32% during 2004/05. At present guidelines for levels of funds to be held for schools is 5% of budget for primary schools (subject to a minimum of £20,000), and 8% for secondary schools unless funds are specifically earmarked. Some schools are above this level, whilst others are below. No recommendations are being made to change the level of these reserves, however Members may want to consider the level of school funds during the 2006/07 revenue and capital budget setting process.

#### 9.14 **Collection Fund**

The Council Tax Collection Reserve is slightly different from all other reserves. Legislation requires any balance to be applied at the next Council Tax setting to the three precepting authorities, having taken into account sums applied during the current year and anticipated receipts. Any balance represents the sum collected over and above the assumed collection rate but is normally collected after the end of the financial year. This issue will be dealt with in the report to Members on the Council Tax Base during the 2006/07 Budget Setting process.

#### 9.15 **Operations Reserves**

The Council has continued to operate a policy in respect of trading reserves held by Operational Services that, in total, the uncommitted balances should be no more than 2.5% of turnover or £300,000 at any one time. The balances shown in the table attached show that balances by the end of the current financial year 2005/06 will have dropped to marginally below the maximum level.

### 10 **Chief Finance Officer Statement.**

10.1 I am satisfied that the Council's General Fund and Earmarked Reserves, including Insurance Reserves, are adequate for the Council's Financial Plans and to meet any known or predicted liabilities.

10.2 The Councils General Fund Reserves of £2.672 million represents 1.8% of the Council's overall 2005/06 budget.

- 10.3 The CIPFA guidance on reserves does not recommend a statutory minimum level of reserves. It states that "Local Authorities should make their own judgements on such matters taking into account all the relevant local circumstances which will vary between Authorities". CIPFA also state that "a well managed authority with a prudent approach to budgeting should be able to operate with a relatively low level of reserves".
- 10.4 A Risk Assessment of all 2005/06 budgets suggest that the maximum overspend in any year if all services were subject to adverse pressures, and where there isn't any specific service related earmarked reserve, would be £4.8 million or 3.2% of net budget. An estimate should be added to reflect any, as yet unknown, in year budget pressures and to reflect the financial risks inherent in any significant new partnerships, outsourcing or capital developments, say £0.5 million. This will result in a required General Fund reserve of £5.3 million or 3.53% of net budget. The current level of General Fund Reserve will cover 49% of the maximum overspend. In this unlikely circumstance the General Fund Reserve will be used in one financial year.
- 10.5 However a prudent risk based approach to budget setting will have mitigated the majority of the risk of an overspend. In addition it is highly unlikely that all budgets will be adversely effected in the same year or that there will be no underspending arising from savings or efficiency improvements. Therefore the General Fund Reserve should as a minimum be equal to 50% of the total assessed risk in any financial year or 1.77% of net budget. Ideally a target balance in excess of the minimum should be aimed for, therefore a target of 2% of net budget or £3 million is a reasonable level of General Fund Reserve.
- 10.6 It is assumed that in the circumstances of a significant overspend within the Council's capital programme this will be covered by alterations to the timing of the Council's capital programme or from additional borrowing within the Council's approved Prudential Indicators. Any additional borrowing costs would have to be met from the Council's revenue budget.
- 10.7 Following consideration of the above in my opinion the current level of general fund reserve should not be reduced, as balances would fall below a prudent minimum level.
- 10.8 As detailed in the Medium Term Financial Plan the ODPM and external inspectors have all commented on the low level of General Fund balance in particular in comparison with similar Councils. As indicated above whilst the Council's general fund balance is low therefore if it were to fall below the current level of £2.6 million then I believe the Council will need to specifically budget for an increase in this balance. At this stage though I would not seek to increase the balance in 2006/07 by specifically budgeting for an increase but achieve this by year end underspends. If, as for 2005/06, the Council allocates a contingency within its Revenue Budget this will provide further resources to apply to any areas of concern within the Council's revenue budget.
- 10.9 Head teachers have indicated that due to ongoing pressures faced by schools there may be a call upon their earmarked school reserves. The impact of using these reserves will need to be taken into account as part of schools financial planning in the medium term.

## 11 **Monitoring and Governance of Reserves.**

- 11.1 Appendix 1 shows the projected balances of the reserves at the end of the current financial year and the 2006/07 financial year. These balances are based upon planned levels of spending, which will be subject to approval by the Council when the overall budget is approved. In the event of any unplanned expenditure occurring in the financial year current Standing Orders and Financial Regulations will apply.
- 11.2 The Reserves will continue to be reported as part of the Council's Statement of Accounts and subject to a formal annual review as part of the budget process. Councillors should assess the Council's General Fund Reserve as part of the annual budget setting process.
- 11.3 As the purpose of each earmarked reserve is clearly stated it is not considered necessary to report movements on earmarked reserves on a quarterly basis to Executive or to the Overview & Scrutiny Board. Any quarterly reporting of issues relevant to earmarked reserves will be on an exception basis.
- 11.4 Any budget variations that are reported to Executive which can not be funded from existing revenue resources will then, as a consequence, impact on the projected balance on the General Fund Reserve.
- 11.5 Schools reserves are part of the delegated schools funding and I recommend the use of these reserves remain the discretion of the Head Teachers and Governing Bodies.

## 12 **Links to other Strategies**

- 12.1 The level of reserves has clear links to a number of other Council plans and strategies. The level of reserves will depend on and be incorporated in these other documents. These include:

### 12.2 **Capital Plan:**

A number of reserves are linked to the purchase or replacement of assets, such as the Cremator Replacement Reserve. This expenditure will be treated as Capital Expenditure and funded from the earmarked reserve.

### 12.3 **Medium Term Financial Plan:**

The results of this review of reserves, in particular the General Fund Reserve balance, will need to be incorporated into the Medium Term Financial Plan. In addition any significant under or over provision on earmarked reserves will need to be included.

### 12.4 **Treasury Management Strategy:**

The Treasury Management Strategy will include the implications of the level of reserves held for potential cash flow for investment decisions. In addition it will assess the cash flow and financing implications of any significant expenditure in reserves.

## **12.5 Business Plans:**

The levels of earmarked reserves should clearly link and be identified in individual services' business plans.

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**Director of Finance**

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## IMPLICATIONS, CONSULTATION AND OTHER INFORMATION

### Part 1

These sections may have been completed by the Report author but must have been agreed by the named officers in the Legal, Finance, Human Resources and Property Divisions.

Does the proposal have implications for the following issues? If "Yes" - give details. <i>delete as appropriate</i>		Name of responsible officer
Legal	None	Bill Norman
Financial – Revenue	Covered in the body of the report	Paul Looby
Financial – Capital Plan	Covered in the body of the report	Lynette Royce
Human resources	None.	Geoff Williams
Property	Covered in the body of the report	Sam Partridge

### Part 2

The author of the report must complete these sections.

Could this proposal realistically be achieved in a manner that would more effectively: <i>delete as appropriate</i>		
(i)	promote environmental sustainability?	No
(ii)	reduce crime and disorder?	No
(iii)	promote good community relations?	No
(iv)	promote equality of opportunity on grounds of race, gender, disability, age, sexual orientation, religion or belief?	No
(v)	reduce (or eliminate) unlawful discrimination (including indirect discrimination)?	No

If the answer to any of the above questions is "Yes" the author must have addressed the relevant issue/s in the main report and have included a full justification and, where appropriate, an impact assessment.

### Part 3

The author of the report must complete this section.

	<i>delete as appropriate</i>	If "Yes", give details
Does the proposal have implications for any other Directorates?	Yes	Reserves support service delivery

Part 4

Is this proposal in accordance with (i.e. not contrary to) the Council's budget or its Policy Framework?		<i>delete as appropriate</i>
		Yes
1.	If "No" - give details of the nature and extent of consultation with stakeholders and the relevant overview and scrutiny body.	
2.	If "Yes" - details and outcome of consultation, if appropriate.	

Part 5

Is the proposal a Key Decision in relation to an Executive function?	<i>delete as appropriate</i>	If "Yes" - give Reference Number
	No	

Part 6

**Wards**

All

**Appendices**

Appendix One: Summary of Reserves 2006/07

Appendix Two: Detail of All Council Reserves

**Documents available in Members' Room**

None.

**Background Papers:**

The following documents/files were used to compile this report:

Medium Term Financial Plan

# APPENDIX 1

## 2006/07 - Review of Reserves

<b>Reserves</b>	Balance as at 1/4/05	Balance as at 31/03/2006	Balance as at 31/03/2007
	£'000	£'000	£'000
<b>General Reserves</b>			
General Fund	2,672	2,672	2,672
Collection Fund Reserve	1,032	982	482
School Balances	3,236	0	0
	6,940	3,654	3,154
<b>Earmarked Reserves</b>			
Approved Service Carry Forwards	1,412	45	45
Art Objects Purchased Fund	19	19	19
Capital Funding Reserve	954	921	566
Car Parks Machine Reserve	107	107	107
Crematorium	535	610	685
Claylands Reserve	25	25	25
Fleet Software	18	18	18
Council Elections	20	40	60
Disposal Costs	39	19	0
Early Retirement Reserve	149	0	93
Equipment Reserves	533	516	516
Financial Strategy Reserves	757	507	507
Hele Signal Maintenance	3	3	3
Junior Life Skills	2	1	1
Insurance Reserves	3,062	3,270	3,499
IT Equipment Reserve	59	0	0
LGR Repayment Reserve	435	365	295
Midas Clarance Hotel 106	1	1	1
PCT Cont to DGS Scheme	31	31	21
PFI Sinking Fund	3,359	3,131	3,537
Pearl Assurance House R &M	55	55	55
Planning Reserve	124	184	245
Section 106 Agreements	86	86	86
SWW Agency	100	100	100
Torbay Enterprise Agency	43	33	23
Vehicles and Plant	244	257	277
	12,172	10,344	10,784
<b>Trading Reserves</b>			
Harbours Reserves	1,307	1,303	1,303
Operations Reserves	441	280	280
	1,748	1,583	1,583
<b>TOTAL RESERVES</b>	<b>20,860</b>	<b>15,581</b>	<b>15,521</b>