

## TORBAY COUNCIL

Report No: **Com/2/04**

Title: **Review of Reserves 2005/06**

To: Executive on 7th December 2004

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### **1. Purpose**

1.1 To review the Council's Reserves as part of the 2005/2006 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 £0.3 million be transferred to the Insurance Reserve and £0.5m be transferred to the Financial Strategy Reserve from other earmarked reserves.

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

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

4.2 The transfer of monies between earmarked reserves better reflects the Council's likely demands on Reserves in the short and medium term.

### **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 take 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 Bill 2002 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      Review of Reserves 2005/06**

8.1      As at 31/03/2004 Torbay Council's reserves were as follows:-

	<b>2003/04</b>	2002/03
	<b>£m</b>	£m
General Fund Reserve	<b>2.3</b>	2.2
Insurance Reserve	<b>2.2</b>	3.2
Schools Reserves	<b>2.2</b>	2.1
Trading Reserves	<b>1.8</b>	2.0
Earmarked Reserves	<b>7.2</b>	8.8
Collection Fund Reserve	<b>0.6</b>	0.7
<b>Total Reserves</b>	<b>16.3</b>	19.0

8.2      A list of the Council's Reserves as at 31/03/2004 as reported in the Council's Statement of Accounts 2003/2004, (now audited) is attached at Appendix 1. (Note: £1.2 million of the insurance reserve has now been reclassified as a provision as it relates to known, but as yet unsettled, insurance claims).

8.3      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 and the cost of rebilling be met from earmarked reserves. For the purposes of this report it is assumed that the Insurance reserve is utilised for this purpose with the monies replaced over the following two financial years.

8.4      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. Each reserve has been assessed by the Service Manager and their accountant for its estimated balance as at 31<sup>st</sup> March 2005 and for the estimated additions or withdrawals from the reserve during 2005/06. This is included in the table at Appendix 1. This table is before recommendations arising from this report.

8.5      In addition each of the pages show an assessment of the current minimum level of the reserve and justification. 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 higher than minimum balance.

8.6      For the reserves where no specific comment has been made below, it is recommended that no changes are made. Changes to the following reserves are recommended or else retained at a higher level than may be deemed appropriate for the reason stated.

8.7      South West Water Reserve (AMX16) – The current balance is £0.231 million but it is considered that a balance of only £0.1 million is required for the reasons given. It is therefore recommended that £0.131 million is transferred from this account.

8.8      Harbour Reserves (BFX15/BRX18) – 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.

- 8.9 Operations Reserves (DxXxx) - The operations division hold a number of reserves that were required under Compulsory Competitive Tendering legislation in that the organisation was required to make a 6% rate of return. Since the abolition of the legislation the division still operates on a trading basis and any losses incurred have to be funded from previous surpluses. At present there is £0.625 million held in these reserves, which represents 5% of turnover. In the light of previous year trading performance and future prospects, it is recommended that a minimum balance of £0.3 million be held, which is 2.5% of turnover, and that a sum of £0.325 million be transferred out of this reserve.
- 8.10 Insurance Reserve (TCX20) – The balance of £2.037 million reflects the position before the utilisation of £0.614 million needed to meet the cuts required by capping. Thus the true balance is approximately £1.4 million which will cover the specified amounts for MMI and residual Devon County Council together with 100% of the Council's annual contribution to the fund. The Council has been witnessing a rise in the value of public liability claims of approximately £0.150 million per annum which it has to cover from the reserve. The Council's actuary has advised that, even after the reinstatement of the capping monies, the Council will need to increase its contribution to the insurance fund by this amount and by similar sums in future years. Whilst work is being undertaken to reduce the possibility of claims against the Council this is a significant charge facing the Council and will need to be addressed if the Council is not to have further revenue pressures in future years.
- 8.11 Vehicle and Plant Fund (XHX40) – With the change in the borrowing regime for capital items, alternative sources of funding could be sought for larger items. Accordingly it is recommended that £0.350 million be transferred from this reserve.
- 8.12 In total therefore it is being recommended that £0.806 million be transferred out of existing reserves. In order to partially address the issues facing the insurance reserve it is recommended that £0.300 million be transferred to the insurance reserve. In addition that a balance of £0.506 million be transferred to the Finance Strategy Reserve (XAX82) to meet some of the prospective budgetary issues facing the Council in 2005/06 and any shortfall in storm damage funding arising from the extreme weather in October 2004.
- 8.13 It should be noted however that the Assistant Director (Operational Services) has raised operational concerns if the level of transfer proposed is implemented. He has indicated existing additional costs relating to refuse vehicle maintenance, additional parks maintenance works being sought and increasing Transfer Station losses all of which will require an increased call on reserves of £40,000 from the levels shown above. These though are not reflected in Appendices I or II. He also feels that a balance of 3% of turnover would be more appropriate which if the two are combined would reduce the transfer from Operations reserves £0.325 million to £0.190 million. Members will need to take these views into account when coming to a final decision.
- 8.14 The External Auditor will be looking closely at the action of the Council when it applies these funds and will be highly critical of the Council as it uses these funds to sustain ongoing revenue expenditure rather than "one off" items. One of the indicators within the CPA "use of resources" block relates to the use of revenue

reserves in balancing the budget and Council's get marked down if these are used inappropriately.

- 8.15 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 collective 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 2005/06 Budget Setting process.

## **9 Storm Damage – October 2004.**

- 9.1 Following the Storm damage in October 2004 the cost to the Council that is not anticipated to be met from insurance cover or the Bellwin scheme is estimated to be £400,000. This will need to be funded by the Council in 2004/05. This funding is likely to be from any revenue savings arising in 2004/05 and use of Council Reserves.
- 9.2 It is suggested that if the Council's revenue budget can not fund all storm damage costs the Financial Strategy Reserve is utilised. This assumes that the recommendations in this report are accepted. If not alternative reserves will need to be identified to fund any excess storm damage costs.

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

- 10.1 I am satisfied that the Earmarked Reserves, including Insurance Reserves after the proposed action in this report, are adequate for the Council's Financial Plans and to meet any known or predicted liabilities.
- 10.2 The Council's General Fund Reserves of £2.259 million represents 1.6% of the Council's overall 2004/05 budget. (2.67% if delegated schools budget is excluded).
- 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 2004/05 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 £4.5 million or 3.3% 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 £5.0 million or 3.7% of net budget. The current level of General Fund Reserve will cover 45% 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 1.8% of net budget.

- 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 During the recent inspection by the Audit Commission, clear concerns have been raised about the level of reserves and, subject to confirmation in the final report, it is assumed this relates to the General Fund balance. As indicated above whilst the Council's general fund balance is currently below my recommended level, the shortfall is not significant, but if it were to fall below the current level of £2.2 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 2005/06 by specifically budgeting for an increase but achieve this by year end underspends.
- 10.9 However an annual contribution should form part of the Councils Medium Term Financial Plan to maintain the balance to at least 1.8% of net expenditure and cognisance should be taken of the Audit Commission view when setting future levels.
- 10.10 Head teachers have indicated that due to ongoing pressures faced by schools there may be a call upon their earmarked 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 Governance of Reserves.**

- 11.1 Appendix 1 shows the projected balances of the reserves at the end of the current financial year and the 2005/06 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. The Reserves will continue to be reported as part of the Councils Statement of Accounts and subject to an annual review as part of the budget process. Councillors should assess the Councils General Fund Reserve as part of the annual budget setting process.
- 11.2 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.

**Richard Thorpe**  
**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	None.	Paul Looby
Human resources	None.	Clare Armour
Property	None.	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  
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

## 2005/06 - Review of Reserves

<b>Reserves</b>	<b>Ledger Code</b>	Balance as at at 1/4/04 £'000	Balance as at 31/03/2005 £'000	Balance as at 31/03/2006 £'000
<b>General Reserves</b>				
General Fund	ZAA99	2,259	2,259	2,259
Collection Fund Reserve	SNX02	589	439	589
School Balances	XEX05	2,203	2,203	2,203
		5,051	4,901	5,051
<b>Earmarked Reserves</b>				
Insurance Reserves	TCX20	2,037	1,492	1,492
PFI Sinking Fund	XEX60	2,038	2,628	3,398
Approved Service Carry Forwards	Various	1,426	4	2
Capital Funding Reserve	YZX11	530	105	118
Early Retirement Reserve	XEX81	390	170	170
LGR Repayment Reserve	XAX84	505	435	365
Vehicles and Plant	XHX40	590	535	525
Cemeteries and Crematoria	XKX92	460	535	610
Equipment Reserves	XAX21	324	362	388
IT Equipment Reserve	XAX85	292	212	212
Revenue Reserve	TCX21	100	0	0
SWW Agency	AMX16	231	231	231
Section 106 Agreements	XLX15/20	112	112	112
Kingskerswell Bypass	XNX32	0	0	0
Car Parks Machine Reserve	XHX31	107	98	98
Council Elections	XAX19	0	20	40
Torbay Enterprise Agency	XNX12	43	20	15
Art Objects Purchased Fund	XCX40	19	19	19
Claylands Reserve	DSX44	15	15	15
Hele Signal Maintenance	XHX04/XHX19	6	4	2
Planning Reserve	XAX83	57	117	177
		9,282	7,114	7,989
<b>Trading Reserves</b>				
Harbours Reserves	BRX15/BFX18	1,146	1,098	1,098
Contracting Reserves	Various	643	603	603
		1,789	1,701	1,701
<b>TOTAL RESERVES</b>		<b>16,122</b>	<b>13,716</b>	<b>14,741</b>