

Eden District Council
Resources Portfolio Holder
25 October 2018

Policy on General Fund Revenue Reserves: Annual Review

Portfolio:	Resources
Report from:	Director of Finance
Wards:	All Wards
OPEN PUBLIC ITEM	

1 Purpose

- 1.1 This reports sets out the Policy on General Fund Revenue Reserves (the Policy) for approval. It is a requirement that there is an annual review of the Policy.

2 Recommendation

That the appended Policy, at Appendix A, is agreed.

3 Report Details

3.1 Reasons for Holding Revenue Reserves

- 3.1.1 Revenue reserves represent accumulated revenue surpluses and are therefore resources that can be used to fund either revenue or capital expenditure. It should be noted that cash balances are usually a lot higher than revenue reserves. This is because, in very simple terms, cash balances (invested through the Council's treasury management operations) represent revenue reserves, capital reserves and monies that the Council has collected through Council Tax and Business Rates, but are yet to pay to the precepting bodies.
- 3.1.2 In general, the Council holds reserves to cover unforeseen circumstances and normal operational cash flow requirements. A good example of this is the potential liability in relation to contamination at Greenside Mine (as referred to in the corporate Risk Register). If it were to be established that the Council is liable for addressing the contamination, there would be a major unbudgeted cost. Use of reserves would be required.
- 3.1.3 Reserves also enable an organisation to take business risks and invest in change. Careful risk taking is essential for any successful organisation that wishes to succeed in a fast moving external environment. The downside of risk taking is that sometimes the failure of a project can lead to costs. Reserves enable a risk to be taken in the knowledge that possible costs can be accommodated. Responding to major change is a feature of local government. This can often require one-off investment to meet up-front costs, for example, redundancies, in the event of an organisational restructuring.
- 3.1.4 Reserves should not be held to fund ongoing expenditure. This would be unsustainable, as at some point, the reserves would be exhausted.
- 3.1.5 Reserves are often important in allowing an organisation to manage a major financial imbalance over an extended timescale. This can avoid knee-jerk service cuts, which might be made on a basis that is not well thought out. This is especially true for this Council, as it plans how to significantly reduce its costs against a very challenging and uncertain financial environment.

3.1.6 The Policy looks at two elements of reserves. The first is a 'normal' level for a Council of Eden's long-term characteristics, such as gross expenditure and commitment to long-term service contracts. The second is an 'abnormal' level of reserves held to reflect short and medium term characteristics. It is not the purpose of this report to consider the actual level of reserves. However, at some £8.4m, reserves as of 1 April 2018 are above the normal level for a Council of Eden's size. The Council has a net revenue expenditure of £6.6m and gross expenditure £21.4m (2017-2018 actual per draft accounts)). This abnormal level of reserves can only be safely reduced to a more normal level once the budget deficit has been eliminated and there are no major financial risks or uncertainties facing the Council.

3.1.7 In assessing the appropriateness of reserves, it is also important to bear in mind any liabilities. Of particular importance is the liability in relation to the pension fund. In the accounts this is stated as £9.6m as at 31 March 2018.

3.2 Resources Plan Commentary on Reserves

3.2.1 The Council's Resources Plan (report F55/18) was agreed by Council on 6 September 2018. It is useful to look at the Plan's commentary on reserves in the context of the Medium Term Financial Plan (MTFP), which sets out their key role in the financial management of the Council.

3.2.2 Section 3.14 of the Plan states:

Reserves

3.14.1 *The Council's strong reserves are an essential element of the MTFP. The Council's Policy on Reserves makes it clear that reserves should not be significantly reduced until the Council has a balanced budget for the foreseeable future.*

3.14.2 *The MTFP shows a balance of £2.2m at March 2022. The Council has set no figure for a minimum level of balances, as this depends on the circumstances facing the Council. However, a level of £1.5m is the sort of level below which the Council should not go. It should also be stressed that such minimum balances are only acceptable if:*

- *The Revenue Account is in balance; and*
- *There are no significant financial uncertainties and risks, for example, change or reduction in Government funding, which is a significant risk in 2020. The Council must review its blue collar, recycling and leisure management contracts from 2022. This is a significant financial risk.*

3.14.3 *Local Government faces continued financial uncertainty and strong reserves are needed to give financial resilience. If the Council had not had strong reserves, the need to meet all the costs of re-running the PNS scheme (as included in the 2010-2013 MTFP) would have required the Council to take emergency action to address the financial impact. It should also be noted that BRRS has introduced greater volatility to Council finances and strong reserves make it easier to deal with year-to-year timing differences. The volatility of BRRS will almost certainly increase from 2020 when the change to 75% retention is introduced.*

3.14.4 *If a number of the key factors in the MTFP turn out worse than expected (see the sensitivity analysis in section 3.17), the Council's forecast revenue position could easily be significantly worse.*

3.14.5 *In conclusion, a higher level of reserves than the normal minimum of £1.5m is not unreasonable, but the current level of reserves does give some scope for:*

- Investment in one-off projects – an example of this is office accommodation. The Council approved a budget of £2.3m on 19 April 2018 (Ref TES22/18) to revise its office accommodation. This is expected to be funded by applying the Council's revenue reserves and paying this back over an agreed timeframe. Should this not be practicable, then the authority given in the report to borrow from the Public Works Loan Board will be used; and*
- Capital funding – revenue contributions from reserves have become the main source of capital funding in recent years. Any further schemes agreed will almost certainly be funded largely from revenue reserves, create ongoing revenue income or be necessary to continue statutory services.*

3.2.3 Whilst the improvement in the Council's financial position has been maintained, the Resources Plan identifies a number of major risks and uncertainties. The main ones are:

- Further reductions in total central government funding for local authorities. Public expenditure reductions will continue for the foreseeable future and are expected to change significantly from 2020; and;
- The volatility of the Business Rates Retention Scheme.

3.2.4 The Audit Findings Report, reported to the Accounts and Governance Committee on 26 July 2018, by the Council's external auditors (Grant Thornton) confirms that the Council is financially resilient. An important element of this is the strength of the Council's reserves. Grant Thornton refer to the strength of the Council's reserves in their report, and confirm this in their Annual Audit Letter presented to Council on 6 September 2018.

3.3 The 'Opportunity Cost' of Holding Reserves

3.3.1 Councils are encouraged to state within their reserve policies what the 'opportunity cost' of holding reserves is. As some Members may be aware, 'opportunity cost' is an economic theory term, which means if you spend something on one thing, you cannot spend it on something else.

3.3.2 Applied to reserves, this is often taken as saying to Councils, if you hold reserves that are too high, you are foregoing the opportunity to lower the Council Tax. This line of thought is fine in a perfect world, but less so where there is constraint on increases in Council Tax.

3.4 Applying and Reviewing the Policy

3.4.1 The Policy is couched in general terms and is designed to be considered in the light of actual circumstances, which vary from year to year. The Policy will normally be used to determine the appropriate level of reserves when considering the Council's Budget Requirement (this is when the Council determines its own Council Tax). As the level of reserves is a key component of what Council Tax is set, this is the obvious time to make a judgement on the level. Setting a level of reserves is essentially a judgement and the Policy is not intended to set an arithmetic formula, which would be simplistic and dangerous.

- 3.4.2 This will also tie in with the statutory requirement placed upon the Director of Finance as the Council's Chief Financial Officer, to report on the adequacy of reserves when the Budget Requirement is set.
- 3.4.3 No changes are proposed to the existing Policy. Having strong reserves has been, and will be, essential to the Council dealing with the difficult environment in which it now operates.

4 Policy Framework

- 4.1 The Council has four corporate priorities which are:
- Decent Homes for All;
 - Strong Economy, Rich Environment;
 - Thriving Communities; and
 - Quality Council.
- 4.2 This Policy forms part of the policy framework.
- 4.3 Portfolio Plans are the means by which the priorities, objectives and strategic action in the Council Plan are delivered.

5 Consultation

- 5.1 There has been no consultation with Ward Councillors or Portfolio Holders.

6 Implications

6.1 Financial and Resources

- 6.1.1 Any decision to reduce or increase resources or alternatively increase income must be made within the context of the Council's stated priorities, as set out in its Council Plan 2015-2019, as agreed at Council on 17 September 2015.
- 6.1.2 There are no proposals in this report

6.2 Legal

- 6.2.1 There are no Legal implications.

6.3 Human Resources

- 6.3.1 There are no Human Resources implications.

6.4 Statutory Considerations

Consideration:	Details of any implications and proposed measures to address:
Equality and Diversity	It is considered that this policy is robust and shows no potential for discrimination against any different protected characteristic groups.
Health, Social Environmental and Economic Impact	None.
Crime and Disorder	None.
Children and Safeguarding	None.

6.5 Risk Management

Risk	Consequence	Controls Required
That the Council would be seen as not following best practice.	The Council would be open to public criticism that high levels of reserves are held without a clear rationale.	Clear, regularly reviewed policy in place.
Policy is seen as a straightjacket.	The Council's discretion in determining an appropriate level of reserves is hampered.	As above.

7 Other Options Considered

7.1 No other options have been considered.

8 Reasons for the Decision/Recommendation

8.1 The appended Policy will help to guide consideration of the appropriate level of reserves in annually setting the Council Tax. The application of the Policy will support the Chief Financial Officer's judgement on the adequacy of reserves that is required as part of the determination of the Budget Requirement.

Tracking Information

Governance Check	Date Considered
Chief Finance Officer (or Deputy)	3 October 2018
Monitoring Officer (or Deputy)	3 October 2018
Assistant Director	Not Applicable

Background Papers: Resources Plan 2018-3033 (Report F55/18), Council, 6 September 2018

Audit of Accounts 2017-2018, (Report F54/18), Accounts and Governance Committee, 26 July 2018

Annual Audit Letter 2017-2018, (Report F62/18), Council, 6 September 2018

Appendices: Appendix A: Policy on General Fund Revenue Reserves 2018

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Policy on General Fund Revenue Reserves 2018

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Accessible Information

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Traditional Chinese

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Polish

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Urdu

اس دستاویز میں شامل معلومات کا خلاصہ درخواست کیے جانے پر مختلف زبانوں اور فارمیٹوں (شکلوں) میں دستیاب ہے۔ ایڈن ڈسٹرکٹ کاؤنسل کے افسر برائے مواصلات سے فون نمبر 01768 817817 پر ای میل کریں۔ communication@eden.gov.uk پر رابطہ کریں یا

Policy on General Fund Revenue Reserves

What are General Fund Revenue Reserves?

The Council's General Fund is where all the revenue income and expenditure of the Council is accounted for. It does not include specific funds, such as the Collection Fund, which account for monies that the Council is acting as agent for.

The reserves are the accumulated surplus of income over expenditure.

General Fund reserves should not be used to fund revenue expenditure on an ongoing basis.

Factors to be taken into account in determining the level of reserves

- **Normal** - the 'normal' level of reserves will reflect the long-term needs of the Council and be based on the ongoing operational requirements of the Council. This will include a number of factors, the main ones being the gross expenditure of the Council and the extent to which long-term service contracts reduce the Council's flexibility to respond to financial shocks. Previously the Audit Commission suggested that a yardstick for 'normal' reserves is somewhere between 5% and 100% of 'net operating expenditure'.
- **Abnormal** - the 'abnormal' level of reserves will reflect short and medium term circumstances facing the Council. An important factor would be any underlying financial deficit, as reserves are likely to be a key part in addressing such a deficit. Other factors would include the level of risk, both involuntary and voluntary, that the Council is faced with. An example of 'involuntary' risk would be impending local government reorganisation. An example of 'voluntary' risk might be a major development which, if successful, would produce a major return to the Council.
- **Opportunity cost** - in setting any level of reserves the Council should consider the 'opportunity cost' of holding whatever level of reserves is set. Certain factors may have a bearing on any opportunity cost, for example, any central Government constraints on Council Tax increases.

Application of Policy

As part of determining the Council's Budget Requirement, the Council's Director of Finance is required by regulations to assess the adequacy of the Council's reserves. In making this assessment this Policy should be used.

Review of the Policy

This Policy should be reviewed annually by the Resources Portfolio Holder and in advance of Council's consideration of the Resources Plan.