

FALKIRK COUNCIL

Subject: REVIEW OF RESERVES STRATEGY
Meeting: POLICY & RESOURCES COMMITTEE
Date: 4 September 2012
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1. INTRODUCTION

- 1.1 I refer to the previous reports to Policy and Resources Committee on 7 August which referred to my intention to bring forward a report following a review of the Council's Reserves Strategy.
- 1.2 The current Council policy on its Reserves Strategy was approved by the Policy & Resources Committee on 15 August 2006. In respect of the Council's Uncommitted General Fund, the policy provides for 2% of annual revenue expenditure to be held as a contingency against unforeseen events and emergencies. Whilst noting the other revenue balances held within the General Fund, the policy did not approve any detailed strategy for retention or protocol for use. This paper will further develop the strategy to include these other balances within a wider review.
- 1.3 The strategy also needs to ensure that in a period of financial austerity and restraint which will require potentially difficult decisions to be taken on savings, that overall Reserves and their deployment are aligned with the Council's priorities and link with the Council's Medium Term Financial Strategy, Corporate Plan and budget process.

2. BACKGROUND

- 2.1 The Local Government (Scotland) Act 1975 provides for Councils to hold the following three funds in addition to a General Fund:-
 - Repairs and Renewals Fund – used to finance repairs, maintenance, replacement or renewal of fixed assets
 - Insurance Fund – used where the Council has opted to carry an element of the risk which could have been covered by procuring insurance cover
 - Capital Fund – utilised to finance capital expenditure from receipts from asset disposals. Falkirk Council has never established a Capital Fund.
- 2.2 Scottish local authorities are also allowed to earmark part of the General Fund for specific purposes. Local Authority Accounting Panel Bulletin number 77 (LAAP 77) issued in November 2008 provides guidance for Chief Finance Officers (CFO) on the establishment and maintenance of local authority reserves and balances. The guidance represents “good financial management and should be followed as a matter of course”. It states that it is the responsibility of the CFO to advise the Council about the level of reserves and ensure there is a clear protocol for their establishment and use.

3. TYPES OF RESERVE

3.1 According to LAAP 77, local authorities when reviewing their Medium Term Financial Strategy should consider the establishment and maintenance of reserves. These can be held for three main purposes:-

- A. a working balance to help cushion the effect of uneven cash flows and unnecessary temporary borrowing
- B. a contingency to cushion the impact of unexpected events or emergencies
- C. a means of building up funds to meet known or predicted requirements by earmarking a portion of the General Fund – although earmarked reserves are accounted for separately, legally they remain part of the General Fund.

3.2 Reserves which can be used to provide Council Services are deemed to be Usable Reserves whilst other Reserves which house accounting adjustments and timing differences are deemed Unusable Reserves and cannot be used to provide Council Services. The rest of this report only deals with Usable Reserves.

4. PRINCIPLES TO ASSESS THE ADEQUACY OF RESERVES

4.1 LAAP 77 states that when formulating its Medium Term Financial Strategy and setting its budget, a Council should take cognizance of a range of factors in determining the adequacy of its Reserves. One of these is the general financial climate. A recent report from the Centre for Public Policy for Regions (CPPR) indicates that the Scottish Government has still to implement the worst of the revenue spending cuts with only round 25% having been applied so far. They highlight the years 2015/16 and 2016/17 as being the “most difficult”. Furthermore, most political commentators and indeed some UK Government Ministers now accept that the current period of austerity will last for around another 15 years. This will have a serious effect on the Council’s grant and ability to generate capital receipts as the Government cuts public expenditure to balance the books.

4.2 The Council should have adequate Reserves in place to deal with unknown factors which can hit the Council without warning. There is also a further range of known factors which have the potential to significantly impact adversely on the Council’s finances. Some examples are:-

- Pay awards outstripping any “allowance” in the Council’s grant settlement
- The impact of Welfare and Benefits reform
- Current UK Government proposals to change the contracting out arrangements for national insurance relating to defined benefit pension schemes which could cost the Council £4m pa. A white paper is intended for issue in Spring next year with an implementation date to be finalised at the Government’s next Spending Review
- The legacy issue from the failed insurer MMI
- The early years impact of the Tax Incremental Financing (TIF) Scheme

These are not the only examples but they demonstrate the nature and scale of potential pressures and the need to have an adequate level of Reserves

5. RECOMMENDED STRATEGY FOR USE

5.1 General Fund

5.1.1 Uncommitted General Fund

As was mentioned at the beginning of this report, the Council has an agreed policy to retain the balance on this Reserve at a level of 2% of annual revenue expenditure. Based on the 2012/13 Revenue Budget this suggests a range of £7m to £10m. The fact that it is a range indicates that the level of Reserves actually held is a matter of judgement rather than an absolute and this judgement has to reflect the wider and future economic climate.

It should be borne in mind that £3.4m of this Reserve was used as part of the 2012/13 Revenue Budget and it is clear that the use of the General Fund on this scale as a means of contributing to the budget is not sustainable nor is it appropriate. The current Reserves Strategy and LAAP 77 both state that this Reserve should not be utilised to fund recurring annual expenditure.

That said, it is recommended that the current strategy of retaining an Uncommitted General Fund Balance of 2% of annual revenue expenditure is still fit for purpose.

5.1.2 Committed Funds/Earmarked Reserves

LAAP 77 states that for each earmarked reserve (earmarked portion of the General Fund) held by a local authority, there should be a clear protocol setting out

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

The earmarked reserves held by Falkirk Council are, the Devolved Schools Management Reserve, the Economic Development Reserve and the Central Energy Efficiency Fund. In addition, the Council also has a Repairs and Renewals Fund which is home to several sub-funds. The recommended protocols for these funds/reserves as required by LAAP 77 are set out below.

5.1.3 Devolved Schools Management (DSM) Reserve

The DSM Reserve was introduced with a view to giving schools more control over their budgets and allowed them to carry forward any over/underspends at the end of the financial year which recognised that it fell prior to the end of the academic year. Initial Guidance suggested devolving a set percentage of budgets to schools, however, recent Guidance from COSLA recommends that the percentages are scrapped and instead the amount devolved should focus on the specific function, powers and controls devolved to headteachers. The revised Guidance also reinforces the need to ensure DSM schemes provide flexibility for effective planning and use of resources, meeting the requirements of 3 year budgeting. Falkirk Council implements the national guidelines and has its own scheme administered by the Director of Education which allows schools to carry forward balances within an agreed tolerance. Any carry forward outwith this tolerance requires justification from the headteacher and agreement with the Director of Education.

In addition to the devolved budgets referred to above, Education Services hold centrally, certain budgets such as the former National Priorities Action Fund, Early Years Development and Accessibility Strategy which are "notionally devolved" to individual schools. Any underspends in these budgets are also carried forward under the scheme.

It is recommended that the DSM Scheme should broadly be contained in its current form.

5.1.4 Economic Development Reserve

The Economic Development Reserve was created as a result of the Council making arrangements to provide investment in buildings within two strategic business parks. The Council acts as a head tenant thereby guaranteeing a return to the relevant investor with the aim of sub-letting the subjects to occupational tenants. The Reserve was established from premium receipts on lease conclusions and it is used to receive “profit rents” and meet deficits between the rent payments due by and to the Council. It therefore helps cover the risk the Council is taking.

It is recommended that the principles for the use of the Reserve as noted above are continued.

5.1.5 Repairs & Renewals (R&R) Fund

The R&R Fund was established in 1996 at local government reorganisation but it is only in the last few years that it has been used to any significant extent.

The Fund is home to several “sub funds” each used for a variety of purposes as noted below.

<u>Service</u>	<u>Purpose</u>
Chief Executive	• Printworks – Replacement of Equipment
Corporate & Neighbourhood	• Building Maintenance Trading Account
	• General Fund Housing – Purchase of Furniture Packages and Building Maintenance Works
	• Seabegs Road Demolition
Development	• Roads Trading Account – Pothole Repairs
	• Waste Strategy
	• Flood Prevention – Grangemouth & Bo’ness
	• Birkhill Mine Demolition
	• Pavilion Improvement
Social Work	• Older Peoples Accommodation and Day Centre Repairs

It is recommended that the purpose of these sub-funds is still appropriate.

- 5.1.6 It is further recommended that the relevant Service Director, for the earmarked Reserve or “sub-funds” under their control should, on an annual basis, prepare a strategy report to CMT detailing the balance held in the Reserve/sub-fund at the start of the year, any proposed transfer during the year and proposals for future use. These reports should be prepared around mid-September each year so that any balance deemed surplus is recommended for transfer to the Uncommitted General Fund.

5.1.7 Central Energy Efficiency Fund (CEEF)

The CEEF was established in March 2005 from monies received from the (then) Scottish Executive to encourage energy related spend to save initiatives. Decisions on spending are taken by the Facilities Officer (Energy/Carbon Reduction) in conjunction with Services and the fund effectively lends the money to Services to enable the projects to be funded with the money repaid over an agreed period. Given that the above procedures work well, that any balance cannot be transferred to the Uncommitted General Fund and that the balance in the fund is constantly at a relatively small level (currently £370k), it is recommended that the existing protocols for use are continued. Notwithstanding the above, it is further recommended that an annual report on the use of the Fund is prepared for CMT around mid-September by the Director of Development Services.

5.1.8 Insurance Fund

The Council's insurance programme is geared to accepting a greater degree of self insurance relative to an acceptable level of risk and with the aim of stabilising the overall cost or risk. It is also a cheaper method than the conventional approach. The Insurance Fund, which has been established for a number of years, meets the cost of insurance premiums and any self-insured costs. The Fund cushions the Council against possible peaks in losses and helps smooth any impact on Service budgets. The Fund is subject to a periodic actuarial review, following which the CFO should produce a report to CMT commenting on the adequacy of the Fund to meet future claims and recommending any resultant transfer of funds to/from the Uncommitted General Fund for that purpose.

5.2 **Capital Reserves**

5.2.1 Capital Receipts Reserve

As mentioned at para 2.1, the Council does not have a Capital Fund but has a Capital Receipts Reserve. The Reserve comprises proceeds from the sale of Council assets. Proceeds from the sale of assets are used to fund the approved Capital Programme and will be transferred from this Reserve as they are applied to fund capital expenditure. The use of funds from the Capital Receipts Reserve is subject to Committee approval as part of the annual capital programme budget and budget monitoring process.

5.2.2 Capital Grants Unapplied Account

The Capital Grants Unapplied Account holds Section 75 contributions from developers and capital grants for which either no conditions apply, or they do apply and have been met. The contributions and grants will be transferred from this account as they are applied to fund capital expenditure consistent with their terms. They are subject to Committee approval as part of the annual capital programme and budget monitoring.

5.3 **Housing Revenue Account (HRA)**

The HRA Reserve has always been a separately identified element of the Council's General Fund.

The principles used for determining the adequacy of Reserves for the General Fund apply equally to the HRA Reserve albeit a different range of additional known factors have the potential to significantly impact on the balance. Some examples are:

- The depressed market for council house sales leading to increased borrowing to sustain the capital programme with resultant increases in loans charges
- The impact of the period of austerity on rent arrears levels
- The impact of Welfare Reform changes on rent arrears levels
- The repayment of £90m in loans leading to a reduction in annual loans charges of approx £5m from 2014/15 onwards
- The impact of interest rates

Although the policy for the Uncommitted General Fund provides for a balance of 2% of annual revenue expenditure, no such policy has been agreed for HRA. Given that the HRA operates in a different environment from the Uncommitted General Fund, including having a level of flexibility on determining rents which is not available to the General Fund with respect to council tax, it is recommended that a minimum balance figure is more applicable and that it is set at 2% of gross expenditure. This would mean a minimum balance of £1.1m based on the 2012/13 budget.

Furthermore as the Housing Capital programme has a much more material interaction with the HRA than the General Fund Capital Programme has with the General Fund then it is not appropriate to look at the HRA in isolation. For that reason it is recommended that the HRA and Housing Capital programme continue to be prepared and approved in conjunction with each other, however given the scale of the effect that the annual reduction in loans charges will have it is further recommended that both the capital and revenue figures are projected at a high level for at least the next 20 years. These indicative budgets should continue to be prepared by the Director of Corporate & Neighbourhood Services in conjunction with the CFO, and should be approved by Members at the budget setting meeting of the Council. Whilst projections will be prepared over 20 years, any formal reporting to Members will tend to be over a reduced timescale (3 to 5 years).

6. REPORTING TO MEMBERS

- 6.1 Current practice has been that the strategy for use of the Uncommitted General Fund and HRA balance is approved each year at the budget setting meeting of the Council and it is recommended that this practice continues.

A change to the current practice for reporting to Policy & Resources Committee is proposed in that following the consideration by CMT of the individual reports from Services as outlined at paragraph 5.1.6, the Financial Position report to the following Policy & Resources Committee will now contain a section detailing any proposed transfers to Earmarked Reserves/Repairs & Renewals Fund for the year. The report will also show the balances on each of these Reserves and any sums recommended for return to the Uncommitted General Fund. A further report detailing any changes to the figures will be presented to the meeting of the Policy & Resources Committee which immediately precedes the budget setting meeting of the Council. This will improve transparency and ensure that Members are aware of the balances in all Council Reserves when making decisions on savings and use of Council Reserves when they are setting the budget.

7. OTHER MATTERS

- 7.1 Falkirk Community Trust also has a General Fund balance and they are currently preparing a strategy for its use.

8. FUTURE REVIEW

- 8.1 Given the economic climate and uncertainty surrounding future Grant Settlements, it is recommended that the Strategy is reviewed prior to 31 March 2015.

9. CONCLUSION

- 9.1 The Council's Reserves Strategy is now approximately six years old and requires to be updated. This is further reinforced by the current state of the economy and the fact that the worst of the spending review cuts have still to come. The need for an up to date Reserves Strategy that is fit for purpose is therefore of the utmost importance given that the current period of austerity is reported to last for another 10 to 15 years.
- 9.2 Although the balance on the Uncommitted General Fund is above the agreed range, the worst of the impact of the spending cuts has still to materialise, which along with the need to keep a balance to cope with unforeseen events means that these balances could very quickly be eroded. The retention of a balance of 2% of expenditure is therefore still deemed appropriate.
- 9.3 The Council has several earmarked Reserves including the Repairs and Renewals Fund for committed purposes. It is essential that the purpose of each Reserve is clearly understood and that there is an agreed protocol for use which accords with the Council's priorities and can enable the use of these Reserves to better feed into the budget process. An annual report to CMT by relevant Directors should fulfill this purpose. Any sums deemed surplus, should properly be returned to the Uncommitted General Fund.
- 9.4 Although the HRA balance is still part of the overall General Fund and is subject to the same factors which affect the balance on the Uncommitted General Fund balance, it has a unique interaction with the Housing Capital Programme and a greater level of flexibility in determining rent levels. Given that a sum of £5m per annum will fall to be deducted from Loans Charges from 2014/15 onwards, it is appropriate that to gain a clear understanding of the overall effect of the Capital Programme on the HRA Loans Charges, that projections for both capital and revenue are prepared at a high level for at least the next 20 years and these indicative projections approved by Members.
- 9.5 Reporting to Members should be improved and the procedures recommended at para 6.1 will ensure greater accountability and transparency.

10. RECOMMENDATIONS

Members are invited to approve the Reserves Strategy as outlined above.

Chief Finance Officer

Date: 15 August 2012

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LIST OF BACKGROUND PAPERS

NIL