Report No. **56/15**
National Park Authority

REPORT OF CHIEF FINANCIAL OFFICER

SUBJECT: FINANCIAL RESERVES POLICY

Section 25 of the Local Government Act 2003 requires local authorities to have regard to the level of reserves needed to meet estimated future expenditure when calculating their annual budget requirement. It is the responsibility of the Chief Finance Officer to advise on the level of reserves that should be held, and to ensure that there are clear protocols for the establishment and use of any earmarked reserves. The Chief Finance Officer is required to advise on an appropriate level of reserves that should be held, based on judgements about matters and taking into account all relevant local circumstances.

RECOMMENDATION:
Members are asked to approve this report

Background Documents
None

(For further information, please contact Richard Griffiths, extension 4815 or by emailing richardg@pembrokeshirecoast.org.uk)

Financial Reserves Policy

1. Purpose

Pembrokeshire Coast National Park Authority is required to maintain adequate financial reserves to meet the needs of the organisation. The purpose of this policy is to set out how the Authority will determine and review the level of its general fund balance and earmarked reserves.

Section 25 of the Local Government Act 2003 requires local authorities to have regard to the level of reserves needed to meet estimated future expenditure when calculating their annual budget requirement. It is the responsibility of the Chief Finance Officer to advise on the level of reserves that should be held, and to ensure that there are clear protocols for the establishment and use of any earmarked reserves.

The Chief Finance Officer is required to advise on an appropriate level of reserves that should be held, based on judgements about matters and taking into account all relevant local circumstances.

2. Reserves

The Authority holds three cash backed reserves: the General Fund, Capital Receipts reserve and Earmarked Reserves.

General Fund

This consists of working balances and general contingency sums which do not have any restrictions as to their use. They can be used to smooth the impact of significant pressures, offset the budget requirement for a finite period if necessary, or held in case of unexpected events or emergencies. It is a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing. It forms part of the General Fund balance.

Capital Receipts

This reserve is a reserve created by the accumulated of funds received from receipts of the Authority's assets disposal. The balances can only be used to fund capital expenditure.

Earmarked reserves

This reserve is a means of building up funds, or earmarked reserves, to meet known or predicted future requirements – these are accounted for separately but remain legally part of the General Fund.

This policy sets out the framework for the use and management of reserves, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice (CIPFA/LASAAC) and agreed accounting policies. Earmarked reserves will be established on a "needs" basis, in line with planned or anticipated requirements. As outlined in the Financial Regulations, approval to set up a reserve must be sought and the report which seeks this approval must identify the purpose of the reserve and how it will be used. Expenditure from reserves, outside of planned budgetary expenditure, can only be authorised through the Virement process, as outlined in the Authority's Financial Standards.

Reserves can only be used once and so should not be held to fund ongoing expenditure. This would be unsustainable as, at some point, the reserves would be exhausted. To the extent that reserves are used to meet short term funding gaps, they must be replenished in the following year. However, earmarked reserves that have been used to meet a specific liability would not need to be replenished, having served the purpose for which they were originally established.

All earmarked reserves are recorded on a schedule held by Finance. The schedule should explain the purpose for which the reserve is held, the estimated opening balances for each year, planned additions / withdrawals and the estimated closing balance. CIPFA guidance on Local Authority Reserves and Balances advises that a statement reporting on the annual review of earmarked reserves should be made to Authority, at the same time as the budget is approved.

3. General Reserve Working Balances

The level of general reserves or working balances is a matter of judgement and so this policy does not attempt to prescribe a blanket level. The primary means of building working balances will be through an allocation from the annual budget. This will be in addition to any amounts needed to replenish reserves that have been consumed in the previous year.

Setting the level of working balances is one of several related decisions in the formulation of the annual budget. The Authority must build and maintain sufficient working balances to cover the key risks it faces, as expressed in its corporate risk register. As a guide, the advice of the S151 Officer is that working balances should be maintained above a minimum level of £350,000 or 5% of the revenue budget, whichever is the highest. In practice, in determining the precise level of reserves above this minimum, the S151 Officer has to consider all of the strategic, operational and financial risks of the authority. An assessment of these risk assumptions, and relevant factors to be considered to address them, is set out in the table below:

<u>Risk items and issues to be considered</u>

Budget assumptions	Issues to consider
The treatment of inflation and interest rates	The overall financial standing of the authority (e.g. level of borrowing, debt outstanding), including ability to respond to unexpected cost
Estimates of the level and timing of capital receipts	The Authority's track record in budget and financial management of changes in property market
The treatment of demand-led pressures	The Authority's capacity to manage in-year budget pressures and strategy for managing demand and service delivery in the longer term
The treatment of planned efficiency savings	The strength of the financial information and reporting arrangements and contingency plans should efficiencies not be achieved
The financial risks inherent in any significant new funding partnerships, major contractual arrangements or major capital developments	The Authority's virement and end-of-year procedures in relation to budget under/overspends. Risk management of partnership or outsourcing arrangements

Budget assumptions	Issues to consider
The availability of other funds to deal with major contingencies and the adequacy of provisions	The adequacy of the authority's insurance arrangements to cover major unforeseen risks
The general financial climate to which the authority is subject	External factors such as future funding levels will influence the authority's ability to replenish reserves

If, in very extreme circumstances, all general reserves were exhausted due to unforeseen spending pressures and commitments within a particular financial year, the Authority would be able to draw down from any uncommitted earmarked reserves to provide short-term resource cover, although this would not be relied upon as the sole solution, and monthly forecasting against budget plans should already have identified that corrective action would be needed and action taken to review in-year budgets.

4. Opportunity cost of holding reserves

In addition to allowing the Authority to manage unforeseen financial pressures and plan for known or predicted liabilities, there is a benefit of holding reserves in terms of the interest earned on funds which are not utilised. This investment income is fed into the budget strategy. However, there is also an "opportunity cost" of holding funds in reserves, in that these funds cannot then be spent on anything else. As an example, if these funds were used to repay debt or support capital investment, the opportunity cost would equate to the saving on the payment of interest and the minimum revenue provision, offset by the loss of investment income on the funds. Using reserves in this way would, however, leave the Authority with fewer funds to either manage unexpected risks or provide the resources to fund the planned expenditure for which the reserves were originally earmarked.

Given these opportunity costs of holding reserves, it is critical that both the number and amount held in reserves continues to be reviewed each year as part of the budget process, to confirm that they are still required and that the level is still appropriate.

5. **Schedule of Earmarked Reserves**

Earmarked reserves are reserves built up in anticipation of planned future expenditure. The Authority has the following reserves established, and the anticipated movements on these reserves are laid out in an annex to the budget report. Published accounting guidance states that the Authority should be clear on the protocol for each reserve.

The statement overleaf set out the position for each of the earmarked reserves held by the Authority. They are to be reviewed on an annual basis as part of the budget setting process.

Schedule of Earmarked Reserves

£000's

	Closing Balance 31 March 14	Transfers from Revenue	Transfers to Revenue	Closing Balance 31 March 15
Receipts In Advance	136	-104	87	119
Asset Management	37			37
Llanion Park	25	-23		2
Planning: LDP	120		100	220
Self-Insurance	30			30
Staff Restructuring	340	-142	200	398
IT/Public Sector Broadband	19			19
National Park Wales	22		13	35
Finance System	19			19
Planning System	100			100
Car Par Integration	77			77
Invasive Species Eradication Program	15			15
Surface Water Drainage	9	-9		
Origins: Castell Henllys Refurbishment	259	-259		
Memorial Donations	2			2
Archaeology	2	-2		
Wellbeing	5			5
Round Houses	100			100
Castell Henllys Tractor			16	16
SDF Funds			100	100
Machinery			27	27
N.P.G. Reduction			100	100
Car Park Resurfacing			100	100
TOTAL	1,317	-539	743	1,521