

# Reserves and Balances Policy

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The Reserves and Balances Policy represents good financial management and should be followed as part of the annual Financial Planning and Budget process, Budget Monitoring and Final Accounts.

### **2 Application**

The general principles set out in this Reserves and Balances Policy apply to North Tyneside Council's General Fund and to the Housing Revenue Account.

### **3 The Existing Legislative/Regulatory Framework**

The requirement for financial reserves is acknowledged in statute. Sections 32 and 43 of the Local Government Finance Act 1992 require billing and precepting authorities in England and Wales to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

The Local Government Finance Act 1992 and Local Government Act 2003 set out a range of safeguards to mitigate against local authorities over-committing themselves financially. These include:

- the balanced budget requirement;
- Chief Finance Officers' section 114 powers;
- the external auditors' responsibility to review and report on financial standing;
- the requirement for the Chief Finance Officer to report to full Council on the robustness of budget estimates and the adequacy of reserves in the Authority balance sheet; and
- the requirement for the Authority to regularly monitor its budget.

Generally, the balanced budget requirement is sufficient discipline for the majority of local authorities. This requirement is reinforced by section 114 of the Local Government Finance Act 1988 which requires the Chief Finance Officer in England and Wales to report to all the Authority's councilors if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that the Authority will not have the resources to meet its expenditure in a particular financial year. The issue of a section 114 notice by the Chief Finance Officer cannot be taken lightly and has serious operational implications. Indeed, the Authority's full council must meet within 21 days to consider the section 114 notice and during that period the Authority is prohibited from entering into new agreements involving the incurring of expenditure.

Local Authority Accounting Practice (LAAP) Bulletin 99 (released July 2014) sets out guidance to local authority chief finance officers on the establishment and maintenance of reserves and balances. The Bulletin states that its guidance "represents good financial management and should be followed as a matter of course". The guidance covers the legislative and regulatory framework relating to reserves; types of reserves; the principles to be used to assess the adequacy of reserves and the Chief Finance Officer's advice to full Council.

Guidance on specific levels of reserves and balances is not given in statute, the published guidance or by the Chartered Institute of Public Finance and Accountancy (CIPFA) (the recognised accountancy body for local government finance) or the

Audit Commission. There is no statutory minimum level of reserves. It is up to local authorities themselves to set their own level of reserves and balances on the advice of the Chief Finance Officer.

### **4 The Role of the Director of Resources (Chief Finance Officer)**

Within the existing statutory and regulatory framework, it is the responsibility of the Director of Resources (in his role as Chief Finance Officer) to advise the Authority about the level of reserves that it should hold and to ensure that there are clear protocols for their establishment and use.

The Authority then, acting on the advice of the Chief Finance Officer, must make its own judgements on the level of reserves and balances taking into account all the relevant local circumstances. These include the operational and financial risks, and the arrangements in place to manage them, including adequate and effective systems of internal control. The duties of the Chief Finance Officer in relation to the level of reserves are covered by the legislative framework described in 3 above. Under the Local Government Act 2003, the Chief Finance Officer must report to the full Council on the adequacy of reserves (section 27) and reserve transactions must be taken account of within the required budget monitoring arrangements (section 28).

### **5 Types of Reserves**

Reserves can be held for four main purposes:

- a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves;
- a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves;
- a means of building up funds, often referred to as earmarked reserves, to meet known or predicted liabilities; and
- A reserve in respect of grants.

In addition, since 2003/04 the Authority has held a Strategic Reserve in its balance sheet. This has been used to manage significant financial pressures which can arise in year, or between years, for example to manage the significant pressures arising from equal pay settlements and costs of non statutory redundancy payments. The reserve has also been used to support the General Revenue budget in periods where the Authority's finances are in transition.

The Authority also holds a pensions reserve as required under International Accounting Standard 19 – Employee Benefits. This is a specific accounting mechanism used to recognise the Authority's share of pension fund liabilities in its balance sheet. As this is a reserve which arises from an accounting standard it is not available to finance expenditure of the Authority.

For each reserve held by the Authority there should be a clear protocol setting out:

- the reason for/purpose of the 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.

This Reserves and Balances Policy ensures that when establishing reserves, North Tyneside Council complies with the Code of Practice on Local Authority Accounting in the United Kingdom (The Code) and in particular the need to distinguish between reserves and provisions.

### **6 Policy and Principles to Assess the Adequacy of Reserves**

The principles used by the Chief Finance Officer to assess the adequacy of unallocated general reserves when setting the budget ensure that account is taken of the strategic, operational and financial risks facing the Authority.

Setting the level of reserves is just one of several related decisions in the formulation of the financial strategy and the budget for a particular year. This is carried out as part of the Authority's Financial Planning and Budget Process. Account is taken of the key financial assumptions underpinning the budget alongside a consideration of the Authority's financial management arrangements. In addition to the cash flow requirements of the Authority the following factors are considered:

- The treatment of inflation and interest rates;
- Estimates of the level and timing of capital receipts;
- The treatment of demand led pressures;
- The treatment of planned efficiency savings / productivity gains;
- The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital investment developments;
- The availability of other funds to deal with major contingencies and the adequacy of provisions; and
- The general financial and economic climate in which the Authority operates.

The Authority holds two types of reserves:

- General unearmarked reserves (the Authority's General Fund Balances); and
- Earmarked reserves held for specific purposes.

It is the current policy of North Tyneside Council for the *General Fund unearmarked reserves* (the General Fund Balances) to be held at a level of at least £7.000m. This is reviewed at least annually, during the setting of the budget. Factors which are taken into account during the review include; the level of balances as a percentage of the net revenue requirement, budget management and monitoring procedures, risk levels and financial projections for future years.

The level of each *earmarked reserve* is assessed separately with reference to the specific liabilities that the reserve represents. This is done in consultation with relevant officers. Individual earmarked reserves are assessed to ensure their adequacy in relation to factors that have become known since the previous year. It is the policy of North Tyneside Council to ensure that the Financial Planning and Budget Process takes account of any need to increase particular reserves due to factors which may arise and to fully account for these factors.

As one of the Authority's earmarked reserves, *the Strategic Reserve* is a significant part of the Authority's strategic financial management, often used to finance large pressures which can arise outside of the Authority's regular budget setting and financial management processes. As such, it has been used to address major spending issues and it is therefore the objective of the Authority to maintain the Strategic Reserve at a level of £10.000m over the medium term. Due to the level of pressures the Authority is managing, driven by external market forces out of the Authority's control, the current projected outturn for 31 March 2023 would result in the Strategic Reserve balance falling below the level of £10.000m at the start of 2023/24. The Medium-Term Financial Plan for 2023-2027 contains planned replenishments to bring the reserve back to this level by 2026/27.

The use of the Strategic Reserve to balance budgets (either revenue or capital) should be very closely considered in line with LAAP (Local Authority Accounting Practice note) 99, which states that, although "balancing the annual budget by drawing on general reserves may be viewed as a legitimate short term option. It is not normally prudent for reserves to be deployed to finance recurrent expenditure". In principle, although the Strategic Reserve may, under certain circumstances, be used to balance the budget of the Authority, it should not be used as a year on year measure to support ongoing revenue spend. The level of the Strategic Reserve and the potential calls against it will therefore be reviewed on a continuous basis, and in the context of the overall financial planning process of the Authority.

Unless expressly agreed by Cabinet as part of the Budget process, the level of balances and reserves will be reviewed by the Chief Finance Officer and Deputy Chief Finance Officer during the final accounts process in consultation with the Elected Mayor, Cabinet Member for Finance and Resources and relevant officers. In addition, the regular budget monitoring process carried out by the Authority throughout the year will report on any changes in the level of balances or reserves. In-year and year-end transfers either into or out of a reserve must be authorised by the Chief Finance Officer and Deputy Chief Finance Officer in consultation with the Elected Mayor and Cabinet Member for Finance and Resources. Full documentation should be retained for all movements into and out of the reserves and balances.

The Reserves and Balances Policy is set in the context of the Authority's Financial Planning and Budget Process and does not focus exclusively on short-term considerations. Balancing the annual budget by drawing on general reserves may be viewed as a legitimate short-term option. However, in the longer term it is not prudent for reserves to be deployed to finance recurrent expenditure: and where such action is being taken this will be made explicit and an explanation given as to how the recurrent expenditure will be funded in the longer term. Advice will be given by the Chief Finance Officer on the adequacy of reserves over the lifetime of the financial plan. This is addressed in the Financial Planning and Budget Process.

### **7 The Reporting Framework**

The Chief Finance Officer has a fiduciary duty to local taxpayers, and must be satisfied that the decisions taken on balances and reserves represent proper stewardship of public funds. Compliance with this Reserves and Balances Policy

assists in allowing the Chief Finance Officer to be satisfied that there is proper stewardship of public funds.

The level and utilisation of reserves is determined formally by the full Council at its meetings to approve the annual budget and the final accounts. These decisions are informed by the advice and judgement of the Chief Finance Officer.

The Reporting Policy of North Tyneside Council is:

- The Financial Planning and Budget process report to the full Council, which sets the Authority budget for the following year, includes a statement showing the proposed use of, or contribution to, general and earmarked reserves for the year ahead. Reference should be made as to the extent to which such reserves are to be used to finance recurrent expenditure.
- In addition, as part of the budget report to full Council the Local Government Act 2003 requires the Chief Finance Officer to make a statement to full Council on the robustness of the budget estimates and the adequacy of reserves in relation to the forthcoming financial year and the period of the Authority's financial strategy (the two year Financial Planning and Budget Process). Where reserves are being used to finance recurrent expenditure, this will be made explicit, and an explanation given as to how such expenditure will be funded in the medium to long term. Advice should be given on the adequacy of, and expected need for, reserves over the lifetime of the financial strategy.
- The Authority's annual statement of accounts includes a required note on the level of reserves in the balance sheet, showing opening balance, net movement in year and year-end balance. Significant reserve movements are explained in the Chief Finance Officer's foreword to the accounts and the covering report to full Council which accompanies the presentation of the accounts. In addition, the financial management outturn report for the year, which is presented to Cabinet for approval, and subsequently to the Finance Sub Committee, includes a full listing of all reserves and an explanation of any significant movements in individual reserves.
- The regular in-year financial management reports to Cabinet and Finance Sub Committee include details of any transactions affecting the Authority's reserves.

### **8 Good Governance**

It is essential that the Authority takes responsibility for ensuring the adequacy of reserves and provisions when they set the budget. This will be subject to the advice of the Chief Finance Officer and the arrangements for reviewing and reporting on the level of reserves and balances as set out above.