

Report to: **Executive**
Date: **6 February 2007**
Report of: **Executive Member for Resources**
Subject: **Review of Reserves and Balances**
Ward: **All**

1.0 Purpose of the Report

- 1.1 To review the reserves and balances prior to finalising the 2007/8 capital and revenue budgets and in preparing the medium term financial plan for the period 2007/8 to 2009/10.

2.0 Consultation

- 2.1 The report has been considered and agreed by the Management Team and the Financial Management Unit.

3.0 Executive Summary

- 3.1 The proposals if agreed will form recommendations to the Full Council when they consider the General Fund, Housing Revenue Account and Capital Programme later in the month.

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- 3.2 The key proposals contained in the report are summarised below:
- 3.2.1 To reduce specific reserves and transfer residual balances of £300k to the general reserves to be utilised to fund an element of revenue one offs as proposed in the 2007/8 budgets. (Paras: 7.2.4 and 7.2.5). Other balances and reserves to be retained at the levels set out in Appendix 2.
- 3.2.2 To retain a working balance of £1.5m, which equates to 8.8% of the general fund budget. (Para: 7.2.7).
- 3.2.3 To establish an Economic Development/Regeneration Reserve to carry out related schemes of that nature and to transfer £408k from general reserves into the reserve. In addition transfer future LABGI receipts to the reserve. (Para: 7.2.11).
- 3.2.4 To establish a Management of Change Reserve to support the general fund budget in the medium term and transfer general reserves amounting to £1.5m into the reserve. (Para: 7.2.15).
- 3.2.5 To agree in principle to release further general reserves to meet priorities subject to final details being approved by the Council. (Para:7.2.20).
- 3.2.6 To note the information regarding the HRA balance and await further reports.

4.0 Background

- 4.1 Section 25 of the Local Government Act 2003 requires local authority Chief Financial (Section151) Officers to report on the adequacy of reserves when setting budgets. Although reserves and balances have in the past been reviewed as part of other

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financial processes given the level of reserves it is now appropriate to strengthen the council's reserves financial arrangements by carrying out formal reviews of the overall position. Although this report is fairly detailed members will appreciate the importance of understanding the reasons for retaining reserves and the rationale behind our approach in managing them.

- 4.2 Reserves have consciously been strengthened over the last 5 years as part of the Council's strategic objectives to stabilise finances, establish policy driven budgets and ensure priorities are properly resourced. Over the period budgets have stabilised, the level of uncommitted general fund reserves increased to a peak of £4.3m at the end of 2005/6 and added to that over the last 3 years significant affordable growth has been introduced into the base budget.

5.0 Why retain reserves and balances?

- 5.1 Prior to reviewing the position it is appropriate to explain the reasons why reserves and balances are retained.

- 5.2 The Chartered Institute of Public Finance Accountants (CIPFA) offer guidance on local authority reserves and balances and although the guidance is not statutory authorities follow it as good practice.

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- 5.3 Balances or Reserves can be established for 3 main purposes: -

- A working balance to cushion the impact of uneven cash flows usually within a financial year thus avoiding the need for temporary borrowing.
- A contingency to cushion the impact of unexpected events or emergencies. For example a flood disaster.
- A means of building up funds often referred to as specific or earmarked reserves, to meet known or predicted liabilities.

- 5.3.1 From time to time it is permissible for general reserves to be used to balance annual budgets in the short to medium term particularly where time is necessary to realign resources to meet the overarching priorities of the Council. However as reserves are finite this practice of course is not sustainable in the long term.

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- 5.4 There is no specific guidance on the level of general reserve an authority should hold CIPFA guidelines advice being that authority's should have a minimum level of 5% and no more than 100% of net budget. The range is wide but understandable because reserves should be based on risk and local circumstances. Determining adequacy requires sound judgment; it is not based on a mathematical formula.

- 5.5 Judgements could be based on a number of factors: -

- The basis of budget assumptions, are they tight or loose.
- The timing of capital receipt income.
- Demand led pressures such as benefit take up.
- Financial risks around major projects.
- Unexpected over spends.
- Horizon scanning in terms of anticipating the impact of government initiatives, national fiscal policies on our corporate plans.

- 5.6 Other factors taken into account could be based on the effectiveness of the Council's financial and governance arrangements.
- Overall financial standing.
 - Track records in budget and financial management. (General reserves are theoretically lower in well run authorities).
 - Strength of financial information and reporting arrangements.
 - How budget variations are dealt with at year-end.
 - The adequacy of insurance arrangements.

5.7 In saying the above the Council has a duty to ensure: -

- Reserves are not deliberately being accumulated to make the financial situation comfortable.
- That budgets are not overstated a consequence of which could be higher council taxes.
- That income from reserves is not too heavily relied upon to balance budgets year on year.

6.0 Position Statement

6.1 Financial discipline has been key to sustaining the Council's financial position reinforced by an appreciation of the need for financial controls by members, management, staff and trade unions.

6.2 Over the period we have achieved the following: -

- Strong reserves
- Robust budget plans in the medium term
- Sustained low council tax increases below national and regional trends.
- Sustained growth particularly in terms of mainstreaming services following the cessation of external funding in some areas.
- Achieving a score of 3 in our Use of Resources Assessment – working at a level above minimum requirements. Only 3 Districts in the North East Region achieved that level.

6.3 Whilst we have seen some favourable grant increases we have also experienced: -

- Low interest rates reducing investment income from previous levels.
- Superannuation costs increasing by 7%, around £800k.
- The rate of increase for salaries and wages exceeding the rate of increase for general or formula grant.
- The introduction of new responsibilities without supporting finance. Examples are Licensing, recycling and tackling anti social behaviour. More inspection followed by increased fees is another area.
- A need to absorb costs arising from the single status implementation.

6.4 Over the period we have seen reserves rise year on year however it should be noted that they are regularly reviewed and members will recall that arising from the 2004/5 financial results the Council released £1.5m of reserves to improve services and increase capacity and performance. For the purpose of the report the £1.5m is *committed*.

At this point in the financial year the Council's uncommitted revenue reserves including working balances are estimated to be: -

6.5 At this point in the financial year the Council's *uncommitted* revenue reserves including working balances are estimated to be: -

General Fund £4.3m
Housing Revenue Account £3.3m

6.6 The Council's specific or earmarked revenue reserves stood at: -

General Fund £5.99m
Housing Revenue Account £0.40m

Please note specific or earmarked reserves are usually monies set aside for particular purposes and have to be spent as described, flexibility is limited on this type of reserve.

7.0 Proposals for Consideration

7.1 Specific/Earmarked Reserves – General Fund

7.1.1 Appendix 2 is a summary of the above reserves valued at just under £6m and it sets out specific reasons why they were established. Having considered the level of these reserves it is proposed that apart from the following they be retained at current levels and continue to be monitored.

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7.1.2 At the end of March this reserve was standing at £482k as a result of the accumulation of non-material savings from support services. In considering this reserve it should be noted that over the last 2/3 years I.T investment particularly as a result of the E. Government agenda has in part been financed through grant and capital resources.

7.1.3 Given the pressure on future capital resources as a result of the slow down and future depletion of capital receipts it is proposed that an element of this reserve should be retained to include the financing of future IT investment, which is an essential ingredient to continue the development of the council and the achievement of efficiencies. This will ensure future I.T. investment is available and take pressure off the capital programme.

7.1.4 Taking account of the current budgetary position on support services it is proposed to reduce the fund to £350k releasing £100k for general use.

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7.1.5 It is considered that the Housing Benefits Subsidy System is now less of a risk than when the reserve was originally established albeit the government has recently cash limited administration subsidy. Whilst it is acknowledged that the reserve was also established to create capacity for the Benefits Section to undertake one off benefit initiatives such as increasing uptake campaigns nevertheless it is proposed that this reserve be reduced to £107k, which would release funding of around £200k.

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7.1.6 This fund will be reviewed shortly and the results will be reported to the Executive Committee.

7.1.7 If the proposals set out above are agreed £300k will be available for use and it is further proposed that the sum is committed to fund an element of the revenue one offs identified in the 2007/8 budget.

7.2 General Fund Reserves – Uncommitted or those not specifically earmarked

7.2.1 For the purpose of this section of the report the estimated value of reserves under consideration is £4.3m. (See para: 6.5 above).

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7.2.2 The following are extracts from the medium term financial strategy (MTFS) in relation to general reserves, which are in, affect reserves not earmarked for use.

1. *Balance of Reserves - General Fund*

Within the strategy the Council will maintain a prudent balance of, £1.5m to meet unforeseen or unavoidable items of expenditure, which may occur.

2. *Use of Reserves above the prudent level –*

Reserves in excess of the prudent balance to be used to pump prime initiatives as agreed by the Council and to stabilise the base budget in the short term until the budget is fully integrated with the council's corporate plans.

Such an approach will take pressure off the base budget and enable future revenue saving initiatives to be financed in the short term.

7.2.3 In considering the level of general reserves the Council needs to consider: -

- A working balance as described earlier in paragraph 5.3.
- The risks facing the council in the medium term.
- The need to recognise the opportunity costs of carrying out courses of action proposed.

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7.2.4 The retention of an appropriate level of balances is fundamental to good financial management and the need to take account of many factors, which may be unforeseen at the time budgets are prepared.

7.2.5 In 2003 the Council agreed a recommendation to retain a working balance of £1.5m as a prudent measure at that time as included in the MTFS. The balance has been retained at that level since then and is risk based. (Appendix 1 sets out the risks in the medium term.

7.2.6 At the time the balance equated to 11% of the net budget, but when compared to the proposed draft budget for 2007/8 equates to 8.2%. In monetary terms 11% equates to £2m.

7.2.7 Although the budget is now more stable than in 2003/4 in real terms the % in relation to budget has fallen by almost 3% or £500,000 in real terms. Given the above a view could be taken that the reduction in working balance reflects confidence and our improved financial position.

meççè-â In view of the above it is proposed that £1.5m is retained as the current level of working balance for the next 3 years. (2007/8 to 2009/10)

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7.2.8 For clarification 'other general reserves' excludes the working balance and this section of the report refers to £2.8m of reserves.

(Estimated position for March 2007 =£4.3m less working balance of £1.5m = £2.8m).

7.2.9 Members will recall that during 2005/6 the Council received grant in respect of the Local Authority Business Growth Incentive Scheme. (LABGI). The allocation of this grant is linked to increases in the national non-domestic or business rates base for the area and are shared between the County Council and the District Council. The council's share was £408k.

7.2.10 The grant is calculated from overall increases in the business rates base over a period of time and it is fair to assume that economic development and regeneration initiatives significantly influenced those changes. For example a major contributor to the level of grant would have been the increase in the rates base in respect of the Dalton Park Retail Outlet.

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7.2.11 Part of the success in attracting economic activity and regenerating the area is the ability to fund feasibility exercises and pump prime investment income through matching funding and setting aside capital and revenue funding has facilitated this. However when reviewing the medium term financial plan the slow down and inevitable reduction of future capital receipts, which is an essential source of capital funding, is identified as a significant risk for the Council. Given the importance of sustaining progress in the District it is considered that the LABGI grant should be used for economic development or regeneration purposes, which will reinforce the council's commitment to sustainable jobs leading to further investment in the area, provide resources for initiatives requiring matched funding and to address future regeneration issues. In the longer term the funding will generate further business growth and possibly more grant.

meççè-â In view of the above it is proposed that £408k is earmarked from general reserves into a newly established Economic Development/Regeneration Reserve. It is further **éèçéçÉÇ** that future LABGI income be transferred into this reserve.

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Èf the above proposal is agreed the uncommitted balance will reduce to around £2.4m (£2.8m less £408k)

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7.2.12 The Medium Term Financial Plan was reviewed mid-year and during budget preparation. Whilst part of the process was dealing with the nuts and bolts elements to determine whether assumptions and forecasts are still accurate more critically risks were assessed over the next 3 years to ensure sufficient funding is in place to enable the council to achieve it's objectives and priorities.

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7.2.13 Emerging issues are identified in the corporate risk assessments and appendix 1 outlines the key major financial issues facing the Council in the medium term. Whilst elements of the risks will be mitigated by the realisation of efficiencies and management arrangements there could be potential funding gaps in the interim whilst efficiencies materialise and budgets are realigned. Whilst the review process attempts to anticipate change and mitigate some of the cost pressures issues emerging from the recent White

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Paper will have a radical affect on service delivery within the Council. In addition the forthcoming comprehensive spending review is expected to add significant financial pressure with further demands for efficiencies. Whilst the Council will achieve the first raft of efficiencies covering the period from 2005/6 to 2007/8 realising a further £2m will be extremely difficult without changes to service delivery, which will take time to achieve.

7.2.14 In addition to the above difficulties are emerging from the preparation of the 2007/8 and future capital programmes. This issue of capital receipts has been raised in previous reports and the balance of capital receipts in hand is diminishing. This development means that capital financing will be dependent on in year realisation of receipts. To finance programmes in this way is a risky strategy because if the receipts do not materialise or are late there could be funding gaps. There are options to deal with the situation, prudential borrowing being one, however such a solution will impact on the revenue position. The position is being considered during the budget process. =

7.2.15 Given the above issues and the uncertainties the draft Medium Term Plan for the next 3 years will show deficits in 2008/9 and 2009/10 and it is likely reserves will be required in the short to medium term to bridge potential shortfalls. In order to maintain progress and avoid reductions in service standards it is prudent to consider establishing a reserve to support the base budget in the interim.

~~mecece-ill~~ In view of the above it is proposed that £1.5m from the uncommitted general reserves is earmarked for a newly established Change Management Reserve to support the general fund budget over the next 3 years.=

7.2.16 Although new reserves have been established in the process the position will be kept fluid by annual reviews of the reserves and as pressures abate reserves can be adjusted.

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7.2.17 If the above proposals are agreed the revised uncommitted reserve balance will in the region of £900k subject to finalisation

7.2.18 Clearly any usage has to be linked to priorities and in considering the position there are a number of issues emerging, which could be considered.

- Community engagement
- Capacity issues around Local Government Review and developing business transformational programmes.
- Recycling contract - 2008/9 onwards.
- Financing the Capital programme

7.2.19 In view of the above it may be prudent to consider the position further in 4 months time (mid May) following the approval of the 2007/8 budget and capital programme and early feedback from the 2006/7 final accounts. In the meantime some thought can be given to potential use.

7.2.20 Appendix 3 sets out the criteria, which was used to agree projects in the last release and it seems appropriate to use a similar approach.

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7.2.21 In undertaking a course of action it is important for members to consider and be aware of the alternatives, which in effect have been foregone. For example we could retain the £900,000 and earn £45k per annum interest, if we utilise the reserves on say service improvements the opportunity cost of this action would be lost investment opportunities amounting to £45k .

7.2.22 In terms of considering use of £900k members could for example consider a range of uses and the discounted options would be the opportunity costs. Options for utilisation are given below and these can be discussed during the decision making process.

- Retain the balance and invest – Income £45k per annum.
- Invest the monies in further improvement of services, which is a key priority. The opportunity cost if this option is discarded is that services will not improve and a key priority will not be met. Cost could be no improvement in services, a poor satisfaction rating from our communities, poor value for money and poor direction of travel assessment from the Audit commission.
- Repay debt. – reduction in costs of £55,000 per annum, which could be invested in the base budget.
- Reduce Council Tax – reduction in Band A of £26 and £39 on a Band D property for one year only.
- Revenue Contribution to the capital programme increasing investment.
- Funding one –off revenue pressures.
- Set aside a sum to encourage ideas to pump priming efficiencies.

7.3 Housing Revenue Account Reserves (HRA)

7.3.1 The anticipated HRA balance at the end of March is estimated to be £3.3m. In terms of the HRA we need to retain a working balance of £800k leaving £2.5m uncommitted.

7.3.2 Recently East Durham Homes requested further release of reserves the key projects being: -

Scheme to replace Doors and Windows	-	£1m
Maintenance Scheme to reduce Voids	-	£400,000

In addition to the above the Company have asked to specifically reserve a sum of £500k for workforce planning issues.

7.3.3 Prior to submitting these requests to the Council for consideration the Director of Finance and Corporate Services has requested the latest financial position of the Company in order to consider the matter. Members are requested to note the above position and await a further report.

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7.3.4 In addition to the HRA general reserves there is a specific provision of £400k, which was set up to smooth out potential volatility within the subsidy position. This reserve will be reviewed during the course of 2007/8.

8.0 Implications

8.1 **Policy**
None

8.2 **Financial**

Financial implications are included in the report.

8.3 **Legal**
None

8.4 **Risk**
A risk assessment is attached and will continuously monitored and managed under the current arrangements.

8.5 **Communications**
None at this stage.

8.6 **Corporate Implications**

8.6.1 **Corporate Plan and Priorities**

The proposals are to ensure the Council is able to meet its overall objectives and agreed priorities.

8.6.2 **Equality and Diversity**
None.

8.6.3 **E Government**
None.

8.6.4. **Procurement**
None

9.0 Recommendation

9.1 The Committee is asked to consider the proposals set out below, which if agreed will form the basis of a future report to full Council.

9.1.1 To reduce specific reserves and transfer residual balances of £300k to the general reserves to be utilised to fund an element of revenue one offs as proposed in the 2007/8 budgets. Other balances and reserves to be retained at the levels set out in Appendix 2.

9.1.2 To retain a working balance of £1.5m, which equates to 8.8% of the general fund budget.

9.1.3 To establish an Economic Development/Regeneration Reserve to carry out related schemes of that nature and to earmark £408k from general reserves to be transferred therein. In addition to transfer future LABGI grant receipts to the reserve.

9.1.4 To establish a Management of Change Reserve to support the general fund budget in the medium term (2007/8 to 2009/10) and to earmark £1.5m of general reserves to be transferred therein.

9.1.5 To agree in principle to release further general reserves to meet priorities subject to final details being approved by the Council.

9.1.6 To note the information regarding the HRA balance and await further reports.

Background Papers

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The Council's Statement of Accounts for 2005/6.
Reports to Executive: General Fund/HRA Out turn Report 2005/6 Dated 27/06/2006.
Annual Audit Letter – Audit commission – March 2006.
Use of Resources Audit Feedback – March 2006
Various Monitoring reports to Executive Committee during 2006/7.