BRENT RESERVES STRATEGY

What are reserves?

CIPFA states in the *Financial Management Code* that “the aim of the authority’s financial reserves is to provide funding for investment in future activities and to act as a safety net in case of short-term financial challenges.”

What is a reserves strategy?

The *Reserves Strategy* defines the level and purposes for which the Council holds reserves. It consists of three key elements:

1. ***Strategy***: what the Council is seeking to achieve through holding reserves;

2. ***Financial Planning***: linking the level of reserves with plans for their use over the period of *Medium Term Financial Strategy* (MTFS); and

3. ***Operational Framework***: how the Council determines the level of reserves, manages those reserves and plans for their use in line with best practice and statutory requirements.

Together these elements set out the Council’s ambition for reserves, the nature of that ambition and how we will provide assurance.

STRATEGY

Why do we need a reserves strategy?

The Council plans its finances over the short term, medium and long term so that it has adequate resources to deliver services for the residents of the borough. As a large, complex organisation, there will always be variations between our actual spending/income and our plans due to variations in demand, demographic change, changes in costs and the funding decisions of third parties as well as the need to deliver projects and investments spanning more than one financial year.

To ensure we can manage these financial risks, whilst being able to maintain services, requires that the Authority holds funds in reserve to meet these costs as and when they arise and to deal with any unexpected emergency that may occur. A reserves strategy enables us to do this in a planned way.

Do we have to have a reserves strategy?

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

There are other safeguards in place that help to prevent the Council from over-committing itself financially. These include:

a) The balanced budget requirement (*Local Government Act* 1992 s32 and s43);

b) Chief Finance Officer's duty to report on the robustness of estimates and adequacy of reserves (*Local Government Act* 2003 s25) when the Council is considering the budget requirement;

c) Legislative requirement to make arrangements for the proper administration of the Council's financial affairs and that the Chief Finance Officer has responsibility for the administration of those affairs (*Local Government Act* 1972 s151);

d) The requirements of the *Prudential Code*;

e) Auditors' consideration of whether the audited body has established adequate arrangements to ensure that its financial position is sustainable. Financial sustainability is covered as part of the *Value for Money Audit*; and

f) CIPFA's *Financial Management Code* requirement that the effective management of reserves is reviewed as part of a formal Financial Resilience Assessment (FRA).

These requirements are reinforced by section 114 of the *Local Government Finance Act* 1988, which requires the Chief Finance Officer to report if there 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 Council will not have the resources to meet its expenditure in a particular financial year.

Whilst it is primarily the responsibility of the Chief Finance Officer to maintain a sound financial position, the external auditors will, as part of their wider responsibilities, consider whether the audited body has established adequate arrangements to ensure that its financial position is soundly based. However, it is not the responsibility of the external auditors to prescribe the optimum or minimum level of reserves for the Council.

FINANCIAL PLANNING

How does it fit with our other strategies?

The *Reserves Strategy* is part of a suite of supporting strategies that supplement the *Borough Plan* and the *Medium Term Financial Strategy*. These detailed strategies provide an additional level of granularity that helps to create a bridge between the over-arching strategies and operational delivery plans

CIPFA's *Prudential Code* requires the Chief Finance Officer to have regard to affordability when making recommendations about the future capital programme. Such consideration includes the level of long-term revenue commitments. Indeed, in considering the affordability of its capital plans, the Council is required to consider all of the resources available to it and estimated for the future, together with the totality of its capital plans and revenue forecasts for the forthcoming year and the following two years.

There is a requirement for three-year revenue forecasts across the public sector and this is achieved through the *Medium Term Financial Strategy* and the annual budget.

The 2021 Autumn Budget and Comprehensive Spending Review (CSR21) provided details of proposed government support for a three-year timeframe, but with only a one-year detailed financial settlement. This creates uncertainty over future funding and provides limited information for planning over the medium term the use of balances and reserves.

How are the level of reserves set?

CIPFA's Local Authority Accounting Panel does not accept that there is a case for introducing a generally acceptable minimum level of reserves. Instead, it is for the Council, on the advice of its Chief Finance Officer, to make its own judgement on such matters, taking into account all relevant local circumstances. What are relevant circumstances will vary between areas. A well-managed organisation with a prudent approach to budgeting should be able to operate with a minimal level of general reserves which are appropriate to the risks (both internal and external) to which it is exposed. In assessing the appropriate level of reserves, a well-managed organisation will ensure that the reserves are not only adequate, but also are necessary.

It is worth noting that not all reserves are usable. Some reserves arise out of the interaction of legislation and proper accounting practice. These are termed 'unusable reserves' as they cannot be used for any other purpose. They are not considered further as there is no need to set their level and no discretion over their creation, purpose or usage.

Types of Reserve

When reviewing the medium term financial plans and preparing the annual budgets, the establishment and maintenance of reserves should be considered. These can be held for five 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.
b) **Contingency Reserve** - to cushion the impact of unexpected events or emergencies – this forms part of general reserves.
c) **Sinking Fund and Smoothing Reserves** – these allow a response to uncertainty in the economic climate and provide assurance on the safety of the Council's financial assets. These are closely linked with the *Treasury Management Strategy* and *Capital Strategy* - these form part of general reserves.
d) **Statutory and Ring-fenced Reserves** – these are held for specific purposes, often set by statute. Examples include grant funding where the expenditure has yet to be incurred (Capital Grants Unapplied), the HRA Balance and the Schools Balances. Although these are legally part of the general reserves, the restrictions and limitations on their use mean that they should be accounted for separately and not viewed as generally usable.
e) **Earmarked Reserves** – these represent a means of building up funds to meet known or predicted requirements, such as planned

investment, capital projects and change programmes; earmarked reserves are accounted for separately and viewed as largely not generally usable. They remain legally part of the general reserves.

In addition the Council holds the following two usable reserves:

a) **Major Repairs Reserve** – this reserve records the unspent amount of HRA balances for capital financing purposes in accordance with statutory requirements for the reserve. This is an HRA specific reserve.
b) **Capital Receipts Reserve** – this reserve holds the proceeds from the sale of assets, and can only be used for those purposes specified in the capital finance and accounting regulations.

OPERATIONAL FRAMEWORK

When establishing reserves, there needs to be compliance with the *Code of Practice on Local Authority Accounting* and in particular, the need to distinguish between reserves and provisions.

The split of reserves into five categories is helpful as each category has its own nature, purpose and planned usage that can be used to determine the required level of reserves.

Working Balance

The cash flow forecast is key to understanding the level of reserve required to cushion the impact of uneven cash flows. The overall size of the net expenditure budget should be used as the reference point for determining the percentage required to be retained as the working balance.

Contingency Reserve

Determining a suitable level of reserve to cover the unexpected is an inexact science. At best this will be an estimate created using risk management techniques to determine the likelihood and impact of potentially disastrous events. Past experience demonstrates the ability of the Council to deliver savings, while dealing with resource reductions and demographic and other demand changes. How these issues have been tackled without overspending the budget will be an important consideration in deciding how much needs to be set aside in reserves as contingency. A reasonableness check also needs to be considered - retaining adequate funds to cover a calamitous event such as a second pandemic may be overly cautious and therefore not prudent as it ties up scarce resources unnecessarily. The contingency requirement should be referenced to a percentage of net expenditure.

The first two types of reserve, although different in nature, involve dealing with the unplanned and unexpected. The Council also hold reserves for planned purposes. It defines these usable reserves under the following headings:

- Ring-fenced and Statutory
  - HRA
  - Schools
  - COVID
- Capital
- Investment
- Sinking and Smoothing
- Service reserves
- Transformation
- General Fund Balance

When considering reserves held for specific purposes that could be freely utilised to fund unexpected expenditure, only the final three headings (service reserves, transformation and the general fund balance) can be used without limitation. The other reserves are either restricted to a specific use or already committed. Theoretically, the General Fund balance could be viewed as the working balance, whilst the other two types of reserve constitute amounts available for contingency purposes.

As stated already, the reference point for determining the target level for the working balance and contingency reserves should be a percentage of net expenditure. The end result will be a single target percentage of net expenditure that should be held. Although CIPFA oppose an arbitrary figure, 5% is widely used in local authorities as such a target. This is viewed as a starting point and tested for adequacy by considering past data and future forecasts. When considering past experience, use has been made of both benchmarking data for other London boroughs, provided by London Councils and CIPFA's Financial Resilience Index, and historic data for the Council. The comparative data shows that the level of reserves at Brent is good and provides strong foundations for long-term financial sustainability.

An analysis has been undertaken of the percentage of over- or under-spend that the year-end outturn represents of the Council's net budget. This shows that at no point in the last 20 years did any year-end overspend equate to as much as 2% of the net expenditure budget. Looking to the future, funding uncertainty, cost drivers, demand pressures and demographic changes have been considered. Further factors such as the effects of COVID-19 and the current high levels of inflation have also been taken into account. The conclusion of this work is that 5% is a reasonable minimum level of general reserves based on past experience and future expectations.

Uncertainty and Smoothing Reserves

At Brent, reserves for insurance, redundancy and welfare reform are examples of this type of reserve. Each is set on the basis of an individual calculation that takes in to account relevant factors and local circumstances. The *Reserves Strategy* recommends that this policy continues with a requirement to demonstrate need and adequacy are a part of the working paper for the calculation of any reserve under this heading.

Statutory and Ring-fenced Reserves

As these arise from circumstances largely prescribed by statute, there is no need to provide further policy on their level or use. The Council divides these reserves between s106/CIL, Ring-fenced and capital reserves. They are presented in the accounts as part of the earmarked reserves.

Earmarked Reserves

Under this heading fall service specific reserves including carry forwards and more general amounts set aside for transformation, service pressures and future funding risks. The need for and level of these reserves should be justified by a calculation demonstrating the requirement for the reserve, its intended purpose, how its level has been determined and plans for its profiled release. This should be aligned with corporate plans and strategies such as the *Borough Plan*, the *MTFS* and the *Capital Strategy* as appropriate. All earmarked reserves should be reviewed annually as part of the closure of the accounts.

MONITORING

The level of all reserves is kept under continuous review by the Director of Finance. This is achieved through revisions to the *Medium Term Financial Strategy* and the budget monitoring reports. Periodic updates will be provided to the Cabinet and the Audit and Standards Advisory Committee. The planned level of reserves will reported to the Council annually via the *Budget Report*.

USE OF RESERVES

The maintenance and use of reserves play a key role in long-term financial sustainability. Just as the creation and maintenance of reserves arises in a structured way through the Council's financial planning process, so the release of reserves needs to be subject to a similarly planned and controlled process. Such a process is provided by the *Scheme of Transfers and Virements,* which sets out specific requirements for the use of reserves. The main points are:

1. Reserves cannot be used to fund overspends without a plan

   Section 3 of the Scheme of Transfers and Virements requires that "Reserves must not be used to fund ongoing overspends unless there is an agreed, realistic plan to eliminate the overspend before the reserve is exhausted (this applies to all reserves, both earmarked and non-earmarked). The Director of Finance must review planned uses of reserves to ensure that these are not being used to hide or obscure systemic overspends. The Director of Finance must report to Full Council report any areas with inadequate plans to address overspends."

2. Budget report must identify the reserves against which overspends can be charged

   Section 3 of the Scheme of Transfers and Virements states that "In certain circumstances where such overspends on Funds arise, there is a choice as to which reserve the charge should be made. The annual Budget Report will identify which reserves overspends will and will not be charged against, for approval by Full Council. In the event of inadequate reserves to fund overspends, the Director of Finance may have to use additional reserves to fund overspends, any such action is to be reported to Full Council. "

3. Budget report must specify how reserves are to be used

   Section 6 of the Scheme of Transfers and Virements directs that "Reserves have been established to aid the smooth running of the Council's finances, and it will be normal to charge costs to those reserves subject to financial regulations and local procedures and policies. Further, the council has capital monies, such as capital grants and capital receipts held in the council's useable reserves. The Schedule of Earmarked Reserves in the Budget Report must specify how the council's useable reserves are to be used, including if they can be used to fund overspends, and this needs to be approved by Full Council as part of the Budget Report. Officers may make transfers from these reserves up to the amounts in the Budget Report for the specified purposes."