

## **RESOURCES SCRUTINY COMMITTEE**

**10TH MARCH 2004**

### **Report of the Head of Financial Services**

#### **ITEM 7      CRITERIA FOR USE OF RESERVES**

##### Purpose of the Report

The Resources Scrutiny Committee requested this information.

##### Recommendations

That the report be noted and comments made as required.

##### Background

The level, and types, of balances and reserves was for many years left to the experience and knowledge of the Chief Financial Officer. Clearly, the members of the authority would approve these but frequently as part of the wider overall accounts and budget approval.

That situation has changed through the publication of the LAAP Bulletin 55 which relates to balances and reserves and the requirement of the Local Government Act 2003, section 27, which places a requirement on the Chief Financial Officer to report the level of balances, movement from and to, and the adequacy of such balances to the Council when the Council Tax and Budget is being set.

A copy of LAAP Bulletin 55 is circulated to members of the Committee to assist members' comprehension of the subject.

This Council has had a Working Balance, a Capital Works Reserve, and a Commutation Reserve as the main revenue reserves for a number of years. The latter reserve was for a specific purpose which has now been removed due to provisions in the Local Government Act 2003.

##### Working Balance

The external auditor commented on the level of working balance in the 2002/03-audit report when the balance was £2m. This sum had been the accepted level for some years but had no defined base other than being a reasonable sum for an authority of this size. The Audit Commission have shown that a balance of 5% of the net revenue expenditure is more an acceptable level of working balance which would indicate a sum of £1m for Charnwood at the present time.

The purpose of this balance is to provide cash flow and to take minor movements from the General Fund outturn each year. However, if there was an overspend which depleted the balance, it would be necessary to include a sum within the next budget to replace the level to that which was then considered adequate.

### Capital Works Reserve

This balance was established to provide funding for committed schemes within the capital programme and which were not backed by specific resources which were certain to be received. Therefore, schemes could be started even though the total funding of the programme was not in place before the start of a financial year.

However, the reserve soon began to be increased due to slippage each year on the amount of funding required from the General Fund revenue. Ostensibly, this funding would be required at a future date when the schemes, which had slipped, were committed, but of course other resources had become available by then, and the link to committed schemes was broken. The reserve became more a 'general revenue' reserve.

In line with current practice the balances were reviewed and this was evidenced in the Medium Term Financial Strategy. Surplus funds from this reserve, the working balance and the commutation were transferred to a reinvestment reserve and the Capital Works Reserve reverted to its original purpose, that is to provide funds for the committed schemes in the next year's programme which are not entirely matched by resources that are certain. The difficult question is clearly what resources are 'certain'.

Prior to April 1<sup>st</sup> 2004, there were credit approvals issued by the Government for borrowing for capital expenditure. These were limited and therefore schemes needed to be funded by revenue contributions, other contributions or capital receipts. It is the latter category that are the least certain as to their exact date of receipt as they involve negotiation with purchasers and the legal complications can be very protracted. Other capital receipts, such as sale of council houses have been consistent over a number of years, in numbers, and their value has increased due to the increase in housing valuations. However, a fall in confidence in the housing market could well see this receipt reducing in any year.

The Capital Programme presented to Cabinet on the 12<sup>th</sup> February 2004 showed that the General Fund committed programme amounted to £8m. The resources to fund that were listed and £4.8m was from capital receipts.

Therefore the 'less certain' elements are £4.8m in that these have yet to be received by the council. However, of this, there are some more certain than others, for example the sale of Limehurst Depot is aligned to the purchase of a new depot, and this will be an arrangement where in effect a 'swap' takes place. The deposit from a major land sale has been factored into the receipts at £1.3m but is still not an absolute certainty, so is included in the 'at risk' category.

Council house sales, usable, of £1.2m are forecast and a third of these are considered to be uncertain enough to be provided for. The remainder of the receipts forecast is mortgages and minor land sales and receipts for which no provision has been made.

From the above it is clear that the position on the CWR will change annually, and of course the position on the receipts will change during the year. Therefore there will not be a 'correct' level of reserve at any one time; only time will provide that proof. The experience of the staff involved in land sales and managing the finances of the capital programme will have to be relied upon in assessing the final level of this reserve.

Of course, the new Prudential Borrowing Code provides a greater flexibility for the Council than before. Resources not received from sales could be replaced by borrowing, as long as this is affordable. The borrowing level has been set at £1.3m currently, but this can be change with the approval of Council during the year.

### Reinvestment Reserve

This reserve has been established to allow, normally, for one-off expenditure that will lead to an on going saving which would produce a pay back, generally within three years.

The opening balance has been derived from the transfers from other reserves that are in excess of their requirements.

There is no defined restriction on using the reserve for only revenue expenditure, but the use for capital schemes, that showed the necessary pay back, would be funded by increasing the Revenue Contribution to Capital, which in turn would be supported by the transfer from Reinvestment Reserve.

There is no intention to replenish the Reserve through the budget savings generated by the expenditure; these would feed through to the annual revenue budget process.

No transfer would be made unless a rigorous appraisal of the proposal had been made on financial grounds so that a pay back was certain.

### Conclusion

The level of balances will be subject to annual review, both during the budget cycle, when a major review will be undertaken, and at outturn when the level of balances compared to budget will be reviewed. The latest information will be used at that time to judge the appropriate level and any management action necessary to amend the position will be reported to Cabinet.

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Background Papers:	LAAP Bulletin 55 Medium Term Financial Strategy Cabinet Budget Reports: December 18 <sup>th</sup> 2003 , February 12 <sup>th</sup> 2004.

the issue is not at a stage where there is a report in preparation for the Cabinet. Therefore, the Committee might wish to programme the matter for consideration by the Committee on a later date