BCP Council

12 February 2020

RESERVES

Background

A local authority must decide the level of general reserves it wishes to maintain before it can decide the level of the council tax it sets. The purpose of general reserves is to manage the risk to the council's financial standing from the impact of excesses to the budget provision and unforeseen events.

In setting the budget the S151 officer is required under S25 of the Local Government Act 2003 to report on **the robustness of the budget** and the **adequacy of reserves** supporting the budget. The requirement on the S151 officer is to ensure that the **budget recommended to council is balanced** (i.e. expenditure matches income), is robust and therefore deliverable and has an adequate level of reserves. The S151 officer is required to ensure that the council's approved budget addresses these three issues.

Ultimately, council will determine the level of reserves and balances formally in setting the annual budget. The advice of the Chief Finance Officer must be formally recorded.

Guidelines

There is no set formula for deciding what level of reserves is adequate. Councils are free to determine the reserves they hold. Councillors are responsible for ensuring that their reserves are appropriate to local circumstances and are accountable to taxpayers for the decisions they make.

It should be stressed that there is **no theoretically "correct" level** of reserves because the issues that affect an authority's need for reserves will vary over time and between authorities. **Reserves should not be seen in a short-term context**. They should be placed in the context of the long-term grant cuts, service pressures and service delivery problems that the council is exposed to. It is however legitimate for the council to call on reserves to mitigate short term pressures, smooth out the impact of extraordinary one-off demands and/or otherwise meet the costs of unforeseen events.

Comparative information

The Chartered Institute of Public Finance and Accountancy (CIPFA) have carried out some benchmarking on the level of reserves held by most unitary authorities and identified that they tend to maintain unearmarked reserves between 5 per cent and 10 per cent of net revenue expenditure. For BCP this would mean maintaining such reserves at between £14.2 million and £28.3 million.

(Net revenue expenditure = £283.013 million, which is our 2020/21 projected net revenue expenditure before reserve movements, revenue support grant, business rates and collection fund surpluses / deficits).

Attached at appendix 3a is comparative information on **unearmarked reserves** against our statistical nearest neighbours based on published financial information. The appendix highlights that our position, based on 1 April 2019 reported positions, should be robust and within the CIPFA range.

APPENDIX 3

CIPFA Financial resilience index

The Chartered Institute of Public Finance and Accountancy (CIPFA) have introduced a local authority financial resilience index, driven by their desire to support the local government sector as it faces the continued financial challenge of government funding reductions and unrelenting cost and demand pressures.

Recently there has been a high-profile financial crisis at Northamptonshire County Council. This coupled with turbulence at other local authorities including the external auditors issuing a s24 (public interest) report regarding Birmingham City Council's use of their reserves, lead to the establishment of such an index as a response to the heightened risks of more council's over the next four years falling into special financial measures.

The index, based on publicly available information, provides an assessment of the relative financial health of each English council. It is not be a predictive model but is a diagnostic tool designed to identify good practice and crucially point to areas which are associated with financial failure. Use of the index should, as part of an early warning system, support councils in identifying areas of weakness and enable them to act to reduce the risk of financial failure.

The index was released nationally in December 2019. The data sets, as backward looking, relate to each of the predecessor councils. Themes within the index which will impact on BCP Council's assessment under the index, will be the high percentage of the councils spend on adult social care, the level of reserves, and the extent to which reserves have been used in recent years.

Chief Financial Officer advice

Reserves are an essential part of good financial management. They help councils to cope with unpredictable financial pressures and plan for their future spending commitments. The level, purpose and planned use of reserves are important factors for elected members and council officers to consider in developing medium term financial plans and setting annual budgets. Having the right level of reserves is incredibly important. Where councils hold very low reserves there may be little resilience to financial shocks and sustained financial challenges, where reserves are high then councils may be holding more than they need.

In advising councillors on the appropriate level of reserves there is also a need to consider the potential financial impact of all strategic, operational and financial risks facing the authority, together with the current overall financial standing of the council including any third-party assessments of this position. The management of reserves will be fundamental to ensuring BCP has a sound financial base on which to deliver its ambitions moving forward.

Organisational and change risk associated with the councils ambitions also need to be seen in the context of local authorities continuing to face some of the most significant financial challenges for a generation. These included the almost the complete removal of government's un-ringfenced core funding to the relevant councils, constrained council tax increases, a decline in other sources of income, rising costs and growing demand for many services the consequences of which will test the council's financial management and resilience well into the future.

In developing a financial strategy to support the delivery of a balanced budget for 2020/21 the Chief Financial Officer undertook a review of all reserves as reported to the cabinet in December 2019. This review was particularly focused on the extent to which further resources might be released to better support the council's priorities and key financial risks. To that effect an additional earmarked reserve of £3 million was created to meet the costs of redundancies not covered by the initial £1.5 million set aside as part of the original Local Government Review (LGR) budget to enable the successful transition to BCP from the four predecessor councils.

In assessing the appropriate level of reserves for the council there are three particular areas of significant financial risk that the council will need to be mindful of, namely;

2019/20 in-year forecast financial outturn

Council budget monitoring for the third quarter of 2019/20 predicts a £5.3 million service pressure for the first year of the new council's operation. This pressure is though mitigated within the parameters of the total budget that was set by the Shadow Authority which included a £2.5 million base revenue budget contingency and £6.5 million of earmarked financial resilience earmarked reserves. These resources having been specifically established to manage emerging in-year issues bearing in-mind 2019/20 was BCP Council's first year of operation.

Looking forward the current in-year forecast, and a £0.7 million transfer to the Financial Liability reserve, will result in £3.1 million being available for drawdown in mitigation in 2020/21 should it be needed. It should be noted that there is still the possibility of the position changing based on the activity to be undertaken in the final three months of the current financial year.

Transformation Funding Strategy

The organisational design work by KPMG, as presented to cabinet in November 2019, established that the Council needed to identify between £20.5 million and £29.5 million to support the one-off revenue and capital investment to enable between £22 million and £36.8 million of ongoing annual savings to be realised. In a report to cabinet in April 2020 the intent is to present the delivery plan to underpin the adoption and implementation of this new operating model. The budget report sets out the strategy to deliver £18.2 million of these resources by a combination of the use of all capital receipts realised over the next two years (estimated at £16.2 million) with a £2 million contribution from the councils Housing Revenue Account. The report indicates that prudential borrowing could be used to support the difference were the expenditure is of a capital nature although such an approach will potential defer realisation of that element of the savings until the borrowing is repaid.

Significantly there will be a high degree of risk associated with;

a) Any residual amount not yet identified.

b) the flexible use of capital receipts strategy as although work has commenced on each of the potential sales the disposals cannot be guaranteed.

Dedicated Schools Grant (DSG) – high needs deficit

BCP Council inherited a £3.6 million accumulated deficit on its Dedicated Schools Grant, mainly associated with the high needs block, as at the 31 March 2020. Third quarter budget monitoring for 2019/20 indicates a £1.9 million in-year pressure which will mean the forecast accumulated deficit as at the 31 March 2020 will amount to £5.5 million.

In respect of the 2020/21 budget the position is that the deficit will grow by a further £2.8 million bringing the forecast accumulated deficit as at 31 March 2021 to £8.3 million. This is though subject to £2.5 million in service-based savings, a £0.2 million transfer from early years and a £4 million transfer from schools.

The position as outlined for 2020/21 is after an additional £3.6 million contribution from the government. A delegation from the DfE Special Educational Needs Team and the Education Skills and Funding Agency are due to visit the council in March 2020 to better understand why the extra government resources are insufficient and to support the council in developing a strategic recovery plan.

Late in 2019 the Government issued a consultation document which stated that the council should not be directly contributing to the high needs block of the DSG as it did in setting the

2019/20 budget. A summary of the indication from government is that they believe they are adequately funding the issue, that they believe the council should not be directly contributing to the issue, and that therefore schools should be bearing the cost if not now at some point in the future. Such a stance is untenable as ultimately the council continues statutorily to retain the liability in its accounts of any accumulated or future deficit on the DSG and there is no indication that schools will be better financed in the future to cover this growing deficit.

The long-held view of council Chief Finance Officers and External Auditors is that councils should be able to able to cover the accumulated deficit on its DSG from its reserves. As BCP Council's deficit grows via both the in-year position and the projected position for next year it is reasonable and prudent to set aside funds to mitigate this deficit in an offsetting Financial Liability earmarked reserve.

To support this approach it is proposed that the council redirects £0.7 million from the Financial Resilience earmarked reserve, redirects the Financial Planning earmarked reserve, directs the unallocated reserves it received from the disaggregation of the balance sheet of Dorset County Council and makes a £1.2 million contribution from the base budget for 2020/21 to create the necessary £8.3 million balance on the Financial Liability earmarked reserve as at 31 March 2021.

The position as proposed will be kept under constant review and should in the future the government issue a specific grant to cover the councils accumulated DSG deficit then at that stage consideration be given to redirecting the Financial Liability earmarked reserve in further support the council's corporate priorities including transformation.

Details of the earmarked reserves held by the council are included at Appendix 3b to this report. It is estimated that their level will be reduced from £52 million as at the 31 March 2019 to £33 million as 31 March 2020. The budget proposal indicates that they will be generally held around this level with the estimate for the 31 March 2021 currently £32 million.

A summary of the council's reserve policy is proposed as follows;

a) An annual risk assessment should be undertaken to support the overall level of reserves, as set out within Appendix 3c.

b) In the medium-term reserves should be maintained to; -

- Offset the accumulated deficit on the Dedicated Schools Grant
- support the council's aims and objectives.
- create a working balance to cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing.
- mitigate the underlying operational risk associated with the operation of a Council and the management of service expenditure, income and other financing items.
- mitigate the risk posed to the Council in terms of the current economic climate.

c) For operational purposes unearmarked reserves should be around **£15.4 million**. This represents around 5.4 per cent of the estimated net revenue budget of the council.

d) As part of the council budget monitoring process, the level of reserves and balances will be reviewed annually to ensure that these are at an appropriate level and in accordance with the policy objectives.

The Chief Financial Officer (CFO) considers the level of reserves as proposed to be adequate for the purposes of the 2020/21 budget. The CFO also considers that in respect of the estimates used to prepare the budget that they provide a robust and reasonable basis upon which to derive such estimates.