APPENDIX

THE RESERVES POLICY

1. Introduction

1.1 It is good financial practice that the Council has a documented and approved Financial Reserve Policy.

1.2 Local Authority Accounting Practice (LAAP) Bulletin 99 published in July 2014 provides advice from CIPFA in respect of Local Authority Reserves and Balances.

1.3 The following Policy reflects the key messages from the LAAP Bulletin and also outlines the practical application for the Council.

2. Types of Useable Reserves Operated by the Council

2.1 Useable reserves are those that can be applied to fund expenditure whereas Unusable Reserves are restricted to accounting entries.

2.2 <u>General Fund Reserve</u>
The General Fund Reserve is split into a non-Earmarked portion and Earmarked Reserve. The former is often referred to as the "Free Reserve" and it is held for unforeseen emergencies and contingencies. The current Council policy is that the Free Reserve should not be lower than £5 million or 2.5% of annual turnover where turnover is defined as General Government Revenue Grant Income and Council Tax Budgeted Income. 2.5% of the current General Services Revenue Budget for 2018/19 is £5.04 million.

2.2.1 Earmarked Reserves are sums of money retained for future use for a specific purpose or commitments made which cannot be accrued at year-end due to not being in receipt of the service or goods.

2.2.2 Within the General Fund Reserve the most significant earmarked balance is for the Devolved School Management (DSM) scheme which facilitates balances being carried forward from year to year by individual schools.

2.2.3 Funds which are not earmarked for specific purposes are set aside to deal with unexpected events or emergencies or at the discretion of Members.

2.3 <u>Housing Revenue Account (HRA)</u>
These are funds which are for use by the Council's Housing Service to smooth expenditure or to fund emergencies. The funds are ring-fenced for the Council's Housing Service.

2.4 <u>Statutory Funds</u>
There are also amounts set aside from the General Fund and HRA balances in Statutory Funds to provide for future expenditure. These are the Repairs and Renewals Fund, which is to assist with uninsured losses to council properties arising from flooding incidents, and the Insurance Fund, which is set aside to pay any uninsured losses regarding school buildings.

2.5 <u>Capital Fund</u>
The Capital Fund is used to directly finance future capital expenditure.

2.6 <u>Capital Grants Unapplied</u>
Holds grants and contributions received towards capital projects. The balance represents funds which have yet to be applied to meet expenditure and would otherwise require repayment.

2.7 <u>Capital Receipts Reserve</u>
Holds the proceeds from the disposal of land or other assets and its use can only be for capital purposes.

3. Governance of Reserves

3.1 The governance arrangements are as follows for each reserve:

3.1.1 General Fund Reserve

- Level of Free Reserves agreed as part of the Reserve Policy and reviewed no less frequently than 3 yearly by the Policy and Resources Committee.
- Projected Balance reported to the Policy and Resources Committee when expenditure for the year is forecast.
- Reported annually to the full Council as part of the review of the Financial Strategy.

3.1.2 Earmarked Reserves

- Creation of Earmarked Reserves approved by the Policy and Resources Committee.
- Update in respect of Earmarked Reserves reported monthly to the Corporate Management Team.

3.1.3 Repairs and Renewal Fund

- Additions to the Repairs and Renewal Fund require Policy and Resources Committee approval.

3.1.4 Capital Receipts Reserve

- o All receipts from sales of assets are paid into the Capital Receipts Fund unless otherwise approved by the Policy and Resources Committee.
- o Capital Receipts Reserve update reported as part of the quarterly monitoring of the Capital Plan to Policy and Resources Committee.
- o Decisions to utilise the Capital Receipts Fund approved by the Moray Council.

3.1.5 Insurance Fund

- o Insurance Fund Balance reviewed and reported as part of the Annual Accounts to the Moray Council.

3.2 Earmarked Reserves Process

3.2.1 An earmarked reserve cannot be established without the approval of the Head of Financial Services and the Policy and Resources Committee.

3.2.2 For each earmarked reserve there needs to be a clear documented understanding of the purpose of the reserve, the timescale for which the reserve is required and anticipated phasing.

3.2.3 For earmarked reserves projecting over £50,000 of spend during the year then the annual spend requires monthly phasing.

3.2.4 As part of the year end accounts the remaining balance and continuing purpose of the earmarked reserve requires reviewing by the budget holder and approving by Finance.

3.2.5 Any earmarked reserve not required is to be written back to the General Fund reserves.

4. Role of the Head of Financial Services

4.1 The Head of Financial Services is responsible for advising on the targeted optimum levels of reserves the Council aims to hold. The Council based on that advice should then approve the appropriate reserve strategy as part of the budget process.

5. Reporting and Review

5.1 The Reserves Policy requires to be reviewed and approved no less frequently than three yearly and reported to the Policy and Resources Committee.

5.2 In the event that it is projected that the Council's Non-Earmarked General Fund Reserve ('Free Reserve') will fall below the approved limit, then the Head of Financial Services should report no later than to the next meeting of the Policy and Resources Committee explaining the reasons for this shortfall and the options available to rectify the situation.

6. Level of Free Reserves

6.1 The level of free reserves held by the Council is a key component in risk management for the Council and so it is considered appropriate that in determining the minimum level of reserves to be held by the Council that explicit recognition of the risks likely to impact on that balance are recognised.

6.2 An update to the Council's corporate risk register was approved by Council at its meeting on 6 June 2018 and includes the following risks with potential financial impact:

1. Demand for services outstrips available budget
2. Savings required to be made to create a sustainable financial operating environment
3. MIJB – no council control but liability for 40% overspend, (if any).
4. Health and Safety incidents
5. Impact of climate change and severe weather events
6. Data protection breaches

The mitigations in place for these risks are set out in the risk register.

6.3 The following points of detail should be considered:

6.3.1 There is anticipated to be increasing demand for council services arising from demographic growth. There is an element of the council's allocation of General Revenue Grant which is based on population numbers. This is based on statistical projections of population numbers from the National Records of Scotland (NRS). Historically these projections have lagged behind the actual growth of Moray's population, which means that existing budgets are under pressure to accommodate population based service growth

6.3.2 The Council is seeing growth of demand for care placements for children and the value of a single case can be a significant unplanned pressure. This would appear to be a national trend.

6.3.3 The Council requires to make significant savings and as yet there is no defined plan to meet the whole funding gap. There is an underlying overspend which had previously been funded from reserves – such funding will no longer be possible.

6.3.4 Savings arising from transformation programmes generally (i) take time and (ii) require upfront funding. A cushion of reserves is likely to be needed for this process. As an illustration the Designing Better Services programme achieved savings of £3 million over an 8 year time frame. There were no savings in year 1.

6.3.5 The Council has been making significant savings since 2008. As time progresses savings are more difficult to find and there is a risk that savings offered are more difficult to achieve. Savings which rely on increased income from charging for services are particularly at risk as the initial impact of increased charges is usually decreased uptake of service.

6.3.6 Part of the council's suite of short term savings measures is the Make Do and Mend approach to asset management and capital spend. This approach carries with it an increased risk of major element failure. This is a particular risk regarding the school estate.

6.3.7 The MIJB budget is also in excess of agreed funding.

On top of this underlying overspend there is currently an overspend against budget. The Chief Officer is committed to providing a recovery plan that will secure a balanced budget positon for 2019/20.

6.3.8 The Council's insurers increased premiums in 2018/19 because of the level of employer's liability claims in recent years. Future risks regarding insurance claims arise from the reduction in roads maintenance budgets. The council has a good record in regard to claims for damage caused by pot-holes but may find it less easy to defend claims in the light of cuts in service. In addition, a saving proposal to increase the level of insurance excess may incur greater expenditure than forecast.

6.3.9 In recent years there have been incidents of road subsidence, requiring repair at costs between £300,000 and £500,000; landslips at Portknockie, and harbour wall breaches at both Lossiemouth and Cullen harbour, again incurring significant cost to repair. This pattern of ongoing weather damage seems unlikely to abate, particularly given the reduction in expenditure on the council's road asset.

6.3.10 The Bellwin scheme, which is designed to assist councils in dealing with major emergencies, does not cover all expenditure incurred by a council and in particular assumes that the council will meet all costs up to the threshold (currently 0.2% of the council's net budget).

6.3.11 The winter maintenance budget is set for a mild winter. Unlike many other councils, Moray does not hold a specific ear-marked winter maintenance reserve for bad winters.

6.3.12 The introduction of the General Data Protection Regulation (GDPR) has brought new and increased, potentially swingeing penalties into play.

6.4 In addition to those risks specifically included in the Corporate Risk Register it should be noted that as the council has reduced its levels of reserves over the last few years. It has also increased the exposure to risk which the council has from budget assumptions used in the financial planning process, as there is less leeway to manage unexpected calls arising from funding being less than expected or expenditure more. Increased demand has been recognised in the risk register, but risk arises also from pay awards and other inflation based increases. Potential unknowns are:

- Pay awards – the pay offer for 2018/19 is not agreed
- The council pay award tends to have a (delayed) effect on pay for organisations delivering services to the council, particularly in the areas of care services, where the council and private or third sector employers are competing to recruit and retain from the same pool of people
- The impact of Brexit on sterling and thence on (particularly) ICT contract prices
- Energy prices, with suggestions that there may be significant price increase
- Inflation is running above the government's target rate. The council does not allow for general inflation but this may influence the likelihood of overspend in an increasingly constrained environment.
- Income available to Scottish Government – with more money generated directly or indirectly from a share of national taxes the income available for Holyrood to distribute is less certain than under the Block Grant system.

6.5 Another factor of note is the extension of time for insurance claims for historic child abuse claims. Claims can now be made for any time after 1964 (previously restricted to 3 years).

6.6 CIPFA in the draft suite of Financial Resilience Indicators (for use in England and Wales) include reference to the availability of council reserves as a test of resilience. In essence the lower the level of council reserves the less resilient that council is in regard to the ability to cope with unplanned events. Benchmarking against other Scottish local authorities shows Moray to have a fairly typical minimum approved level, with 1.5% - 4% of annual turnover being roughly the range reported and 2% the most common. The table in para 6.7 below provides an assessment of financial risks that informs the council's 2.5% position.

6.7 As a test of the reasonableness of that level the following table gives some guidance:

Risk	**Proposed measure**	**£000s**
Rise in demand	Average growth in out of area placements for the last 2 years	600
Pay award	Increase from government target to current rate of inflation (2019/20 budget provision)	500
MIJB	Level of budget above funding (council share)	1,300
	Overspend / demographic growth	1,000
Insurance claims – employer's liability	Average claims over last four years	250
Insurance claims – pot holes	Based on previous numbers of claims in a bad winter	100
Infrastructure failure	Average over last 2 years	600
Emergency event	Bellwin threshold	400
Winter maintenance	Average spend above budget for last two years	350
Budget variance	Based on average of last 2 years Directors of Finance PIs (1% variance)	2,000
Government grant less than forecast	Sensitivity 1%	1,500
Interest rates	Increase in loans pool rate from higher borrowing charges (2015/16 rate)	1,350
Total		9,950

A free reserve of £5 million gives 50% coverage of the quantified risks above. It is unlikely that all of these scenarios would arise and so 50% coverage is considered reasonable. It is not considered prudent to reduce the level of free reserve below £5 million. This currently represents 2.47% of the Council's General Services revenue budget.