

## **Annex 2**

### **FINANCIAL RISK ASSESSMENT AND LEVELS OF GENERAL FUND RESERVES**

#### **1.0 Background**

- 1.1 It is important that the Council has sufficient reserves and balances to enable it not only to maintain its financial standing but also to ensure that the Council can realise its service provision expectations.
- 1.2 The process used to determine and approve the level of reserves gives a good indication of an authority's approach to financial management, and is reviewed by the External Auditor when determining whether or not an authority's financial standing is soundly based. To assist local authorities the Chartered Institute of Public Finance and Accountancy (CIPFA) has published a Local Authority Accounting Practice (LAAP) bulletin that provides best practice guidance on the management of reserves and balances.
- 1.3 In accordance with the CIPFA guidance, the relevancy and adequacy of the levels of reserves for the Council should be reviewed on an annual basis. This review considers the outcomes of a financial risk assessment, to ensure that as a minimum there are sufficient balances to support the budget requirements and adequately mitigate the risk of significant financial loss in the medium term.
- 1.4 The review undertaken as part of the 2013/14 budget build recommended that a level of 12% of the net revenue budget was appropriate. This report considers the current position and anticipated future requirements for inclusion in the 2014/15 budget and medium term.

#### **2.0 Types of Reserve**

- 2.1 There are two different types of reserve, general and earmarked, which are held for different purposes and are managed depending upon their type. The recommendations for both types are covered in the paragraphs below.

##### **General Reserves**

- 2.2 General reserves should only be called upon to meet unanticipated expenditure arising from unexpected or emergency events. Prior to using the general reserves Members' approval will be sought, unless the nature of the emergency makes prior approval impossible, in which case the Section 151 Officer, in consultation with the Senior Management Team, the Leader and other Group Leaders, is authorised to approve the use of general reserves.

2.3 General reserves are held for two main purposes: as a contingency and as a working balance. These terms are explained more fully below:-

- i) **As a Contingency** - To provide funds for any events that are unable to be contained within the limits of the revenue budget due to unexpected incidents or emergencies. These types of events can include natural disasters, national emergencies, or in fact any unplanned event that draws upon an authority's resources, which cannot be covered by normal insurance arrangements. These also include in year budget fluctuations arising from demand led pressures and delays in delivering planned efficiency savings.
- ii) **As a Working Balance** – A certain level of balances are needed to act as a cushion to deal with changing demands on an authority's bank balances from fluctuations in cash flows as a result of normal business. A correctly sized reserve should avoid the need for temporary borrowing whilst not tying up unnecessarily large amounts of cash. Such reserves are only consumed on a temporary basis as they are subsequently replaced from the regular income that funds the authority.

### **Earmarked Reserves**

2.4 Earmarked reserves are sums specifically held to enable funds to be built up to meet known or predicted expenditure. They can be set up using one-off funds (such as year-end under-spends or grants) or by budgeting for a fixed amount to be taken from the revenue account each year and "saved" separately. Any expenditure then incurred within the year is taken from this "savings account", thereby smoothing the impact on Council Tax.

### **3.0 Annual Review of Reserves**

3.1 A well managed authority with a prudent approach to borrowing should strive to maintain as low a level of general fund reserves as possible, whilst still covering its financial risks.

3.2 The most robust means of assessing the adequacy of an authority's reserves is through a comprehensive financial risk assessment, which determines the degree to which the authority is exposed to uninsured and unbudgeted losses. This must be done with knowledge of the context in which an authority operates.

3.3 A summary of the financial risk analysis is shown in the following table. The risk of financial loss can come from a wide variety of places, and although the list below is comprehensive, it is by no means exhaustive. The risks have

been assessed in the context of the Council's overall approach to risk management and internal financial controls. This information has then been used to determine the optimal level of reserve holdings needed to meet the requirements of the contingency and working balance, details of which are covered later in this document.

### 3.4 Risk Assessment for the General Fund Balance

<b>Risk</b>	<b>Likelihood &amp; Value £'000</b>
<p><b>Natural disasters and national emergencies</b></p> <p>The Bellwin Scheme provides financial assistance to local authorities in the event of a national emergency or disaster, subject to an authority contributing to the total costs by an amount equivalent of 0.2% of its approved budget. For this Authority this would require approximately £40k.</p> <p>Business Continuity - It is difficult to anticipate the cost of such an event that would affect the Authority's business continuity, although it is likely to be substantial. For example, in the event that the offices became unusable, the cost of introducing new working practices (e.g. home working facilities, finding alternative accommodation) would have to be met, as would possible increased legal claims were service delivery detrimentally affected. In the case of the failure of a key system, costs could arise from needing urgent consultancy or replacement equipment, which could be costly at short notice.</p> <p>Ash die-back outbreak – if there were to be a full blown outbreak in the Council's mature stock of ash trees, the potential cost to the Council could be £50k.</p> <p>Coastal defences – the Council's coastline could be exposed to erosion or flood risk in the event of a storm</p>	<p><b>Low</b></p> <p>40</p> <p>200 – 500</p> <p>0 – 50</p> <p>100 - 200</p>
<p><b>National Economic Issues</b></p> <p>Under the new Business Rates Retention Scheme, the Council could face reductions in business rates income of up to £330k before the safety net mechanism would kick in</p> <p>The Welfare Reforms could lead to an increase in homelessness costs and also, the new Council Tax Reduction Scheme may lead to a worse collection rate than that budgeted</p> <p>The Council has some contractual arrangements whereby if the contractor were to go into liquidation, the Council would lose a significant income stream.</p>	<p><b>Medium</b></p> <p>0 - 330</p> <p>0 - 100</p> <p>100 - 200</p>

<b>Risk</b>	<b>Likelihood &amp; Value</b> <b>£'000</b>
<p>The Council has a wide range of contractual arrangements that could see a financial loss in the event of the bankruptcy of a supplier or a customer, including non-payment of debts. Although the Council maintains a bad debt provision it is unlikely to be able to fully fund a loss from a major contract.</p> <p>Although the Council tries to minimise investment risk by only investing with low risk organisations and by spreading the investment portfolio, there is still a potential risk of a bank in which the Authority has invested collapsing.</p>	<p>100 – 250</p> <p>0 – 2,000</p>
<p><b>Grant Funding</b></p> <p>The Council sometimes seeks external funding/grants for one-off projects. In the event that the expected projected outturns are not achieved, repayment of funding or grant may be required.</p>	<p><b>Medium</b></p> <p>100 – 2,000</p>
<p><b>Financial Support</b></p> <p>The Council has provided a soft loan to Vista Leisure. Were Vista Leisure to go out of business, the Council may not be repaid this loan.</p>	<p><b>Low</b></p> <p>0 – 250</p>
<p><b>Property Assets</b></p> <p>The identification of unplanned major works to the Council's property portfolio could give rise to a budget pressure. As a responsible owner and with a duty to care, the Council could be expected to fund major works at short notice. Although the initial response would be to look to re-phase the capital programme, this may not be feasible, and additional revenue funding may be required, or prudential borrowing. Due to recent urgent repair works required at the Port and Harbour and the Wintergardens, there is evidence that there is a high risk of this occurring.</p>	<p><b>High</b></p> <p>0 - 1,000</p>
<p><b>Legal Issues</b></p> <p>It would be prudent for the Authority to make provision for an unfavourable outcome of any legal action taken against it, which could be made on a range of different grounds, including compensation payments, equal pay, discrimination and corporate manslaughter.</p> <p>Where the Council provides a paid service to a third party that does not directly relate to any statutory duty, the Council may require Professional Indemnity Insurance. This insurance cover is not automatically arranged and in the event that it isn't and a claim arises the Council could be deemed liable for resulting costs.</p>	<p><b>Medium</b></p> <p>100 – 2,000</p> <p>100 - 250</p>
<p><b>Financial Risk Exposure</b></p>	<p><b>840- 9,170</b></p>

- 3.5 **Proposal for the Level of the General Fund Reserve** - The financial risk assessment indicates that in the worst case the Authority could require £9,170k of its net service revenue budget requirement to fall back on, should all of the potential risks happen concurrently and at their most extreme. Ideally the General Fund Reserve balance should be somewhere between the range identified in the table. The current General Fund Balance level is 12% of the net revenue budget requirement (£2.177m). Based on the current budget proposals, the General Fund Reserve balance for 2014/15 is likely to be around £80k above the recommended limit and this sum would therefore be available to transfer to the Priority Improvement Reserve.
- 3.6 **Plans for the General Fund Reserve 2014 - 2018** – It is recommended that no withdrawal from general reserves is made to support the base budget in the medium term.

### **Assessment of Need for General Fund Earmarked Reserves**

- 3.7 In addition to the level of General Reserves, the Authority maintains a number of reserves specifically set up to meet particular service requirements. These are detailed below:-
- i) **Insurance Risk Management Fund** - This reserve is held to meet potential increases in insurance premiums and to cover the cost of large excesses relating to insurance claims or one-off premiums. As at 1 April 2013, the balance on the reserve was £222k.
  - ii) **Local Plan** – Due to the variable profile of spend on the Local Plan and the variable cost in relation to consultation and inspection, it is proposed that any under-spend on this activity be set aside in this reserve to be drawn against as required.
  - iii) **General Fund Repairs** – This reserve makes provision for necessary essential repairs and maintenance and minor improvements to the Council's assets.
  - iv) **Office Accommodation** – A balance of £9k is held in this reserve which may be used to support any office accommodation changes required as a result of the forthcoming restructure.
  - v) **Revenue Projects (Slippage) Fund** - The annual budget is developed to meet the costs of the purchases and services planned for that financial year, however due to accounting rules, any goods or services that are delivered late (beyond 31 March) are unable to be counted within the financial year. To enable all planned costs to be contained within budget, Members have approved the establishment

of a reserve to carry forward budget that remains unutilised as a result of slippage of a significant value. The reserve is simply used to roll the amount forward into the accounts of the following year to settle the account once the purchase is complete. Failure to do this would result in an under-spend in one financial year and an overspend in the following year.

- vi) **Information Technology Fund** – This reserve was created to support the development of new information technology initiatives to improve efficiency throughout the Council's activities. The annual budget includes provision for IT related projects. Where the projects are not delivered within the financial year, the unutilised budget is transferred to this reserve to be spent in future years. As at 1 April 2013, the balance on this reserve was £486k.
- vii) **Environmental Action Plan Fund** – The Environmental Action Plan (EAP) is a fundamental part of the Council's Corporate Plan and a key corporate priority. The EAP Fund has been established to finance various improvements to public assets throughout the district. The balance on the fund will be drawn down for EAP related expenditure over the period of the Medium Term Financial Strategy 2014-2018.
- viii) **Decriminalisation Reserve** - This reserve is used to meet parking or transport related expenditure. Charges raised from on-street car parking are transferred into this reserve, as required by the Road Traffic Act (1984) as modified by the Traffic Management Act (2004), to be utilised on future parking, transport or environmental improvement related schemes. It is planned to use £40k per annum from this reserve to meet the costs associated with such schemes. The funds within this reserve are not available for general council use.
- ix) **Priority Improvement Reserve** – This reserve is for one-off projects and pump-priming investment into service improvements with a particular emphasis on invest to save projects and activities that will lead to greater efficiency.
- x) **Customer Services Reserve** – This reserve is for housing benefit subsidy. Due to the volatility of this activity and the tight financial constraints which preclude the budget being set at a level that would be sufficient for upper activity levels, it is prudent to set aside under-spends that arise in this area as a contingency for future years. The reserve will also support any potential shortfall in business rates, under the new business rates retention scheme, that won't be covered by the safety net mechanism.

- xi) **Area Based Grants** – The under-spend against the Area Based Grant funding has been carried forward in this reserve and will be utilised over the next couple of years.
- xii) **Waste Reserve** – Service under-spends have been set aside in this reserve to support future service enhancements and the costs of replacing the waste fleet.
- xiii) **Cremator and Cemeteries** – This reserve was created to hold the surcharge element of the cremator fee. This was set aside to meet the cost of the cremator project being undertaken in 2012/13, the purpose of which is to ensure the Council is environmentally compliant. The surcharge on both cremations and burials will continue to be set aside to support future burner replacement and works required at the cemeteries.
- xiv) **Council Elections Fund** – A sum of £30k is being set aside each year towards the costs of the District Elections.
- xv) **Homelessness** – Service under-spends are held in this reserve to meet future homelessness needs.
- xvi) **Renewal Reserve** – This is a saving account for specific purposes, based on the average annual amount required e.g. for the cost of CRB checks.
- xvii) **Maritime Reserve** – A sum of £723k is held in this reserve as at 1 April 2013 to support improvement works at the Port and Harbour and for income protection/maximisation works. A draw down in the region of £400k may be required in 2013/14 to support the budget shortfall following the cessation of the Transeuropa ferry service.
- xviii) **Pensions Reserve** – Savings on pensions costs have been set aside in this reserve to meet any additional costs that may arise as a result of future actuarial valuations.
- xix) **VAT Reserve** – Monies received in respect of the Council's VAT Fleming claim were put into this reserve. If the Council were to breach its partial exemption VAT limit, the potential cost to the Council would be between £400k and £500k. The Council is currently very close to this limit and therefore there is a real risk that this money may be required.

- xx) **East Kent Services** – The year-end surpluses of East Kent Services are set aside in this reserve which the Council holds as accountable body.
- xxi) **New Homes Bonus** – Allocations of New Homes Bonus have been set aside in this reserve to support one-off projects. An annual draw down of £185k has been agreed to support the events and floral grants budgets. The reserve will also be used to support shortfalls in the budget due to cuts in the formula grant.
- xxii) **Housing Intervention** – This reserve is held to support the associated one-off costs (e.g. Compulsory Purchase Orders) of the housing intervention project.
- xxiii) **Economic Development and Regeneration Reserve** – This reserve is held to support one-off service improvements and initiatives encouraging economic growth. This may include consultancy costs associated with such projects.
- xxiv) **Pay and Reward** – This is to support the new pay and reward scheme.
- xxv) **Vehicle, Plant and Equipment Replacement** – The Council has identified that there are a number of vehicles, plant and equipment that will be coming to the end of their useful lives over the next few years. Any service in-year underspends in relation to waste, street cleansing, maritime, parks and grounds will be set aside in this reserve to support a replacement programme.
- xxvi) **Dreamland Reserve** – Monies have been set aside to bolster the contingency for the Dreamland project.
- xxvii) **Coastal Infrastructure** – A sum of £500k that had been set aside within the New Homes Bonus Reserve for the Local Authority Mortgage Scheme is no longer required as the scheme has been put on hold. This money has therefore been moved to a new reserve to support the objectives of the Destination Management Plan by enhancing council assets that help to support and encourage tourism.
- xxviii) **HRA Properties Reserve** – This reserve was set up to support the purchase and refurbishment of HRA properties.



The anticipated movement on each on the approved earmarked reserves is shown in the following table:

<b>PROPOSALS FOR THE GENERAL FUND EARMARKED RESERVES</b>	<b>Balance 31/3/13 £'000</b>	<b>2013/14 Net Transfers £'000</b>	<b>Balance 31/3/14 £'000</b>	<b>2014/15 Net Transfers £'000</b>	<b>Balance 31/3/15 £'000</b>
Insurance Risk Management	222	-75	147	0	147
Local Plan	392	0	392	0	392
General Fund Repairs	368	-200	168	-50	118
Revenue Projects	987	-987	0	0	0
Information Technology	486	-200	286	-100	186
Environmental Action Plan	212	-50	162	0	162
Office Accommodation	85	-76	9	-9	0
Cremator and Cemeteries	182	0	182	0	182
Decriminalisation fund	145	0	145	-40	105
Priority Improvements	874	-354	520	-100	420
Customer Services Reserve	1,010	-400	610	0	610
Area Based Grants	477	-150	327	-327	0
Waste Reserve	347	0	347	0	347
Council Elections Fund	87	30	117	30	147
Homelessness Fund	201	0	201	0	201
Renewal Reserve	42	-35	7	0	7
Performance Reward Grant	55	-55	0	0	0
Maritime Reserve	723	-400	323	0	323
VAT Reserve	441	-20	421	-20	401
Pensions Reserve	661	0	661	0	661
East Kent Services Reserve	754	0	754	0	754
New Homes Bonus Reserve	782	453	1,235	597	1,832
Housing Intervention Reserve	682	0	682	0	682
Economic Development & Regeneration	339	-20	319	-167	152
Pay & Reward Reserve	380	0	380	0	380
Vehicle, Plant & Equipment	0	227	227	0	227
Dreamland Reserve	0	0	0	247	247
Coastal Infrastructure	0	500	500	0	500
HRA Properties Reserve	500	0	500	0	500
<b>Total</b>	<b>11,434</b>	<b>-1,812</b>	<b>9,622</b>	<b>61</b>	<b>9,683</b>

#### **4.0 Proposed Reserve Levels**

The levels of General Fund Reserves (General and Earmarked) recommended in this report for the financial year 2014/15 and the medium term are believed to be sufficient to meet all of the Authority's obligations and have been based on a detailed risk assessment. In line with the proposed policies on the control and management of these funds the limits will be reviewed on an annual basis against prevailing risk assessments and other information.