

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 2015-16 budget build recommended that a level of 12% of the net revenue budget was appropriate, this being circa £2m. This report considers the current position and anticipated future requirements for inclusion in the 2016-17 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

| Risk | Likelihood & Value £'000 |
|---|---|
| Natural disasters and national emergencies | Low |
| 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. | 40 |
| 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 | 200 – 500 |

| Risk | Likelihood & Value £'000 |
|--|--|
| <p>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>0 – 50</p> <p>100 - 200</p> |
| <p>National Economic Issues</p> <p>Under the new Business Rates Retention Scheme, the Council could face reductions in business rates income of up to £340k before the safety net mechanism would kick in</p> <p>The Welfare Reforms, if fully implemented could lead to an increase in homelessness costs</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>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>Low</p> <p>0 - 340</p> <p>0 - 100</p> <p>100 - 200</p> <p>100 – 250</p> <p>0 – 7,000</p> |
| <p>Grant Funding</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>Medium</p> <p>100 – 4,000</p> |
| <p>Financial Support</p> <p>The Council has provided a soft loan to Your Leisure. Were Your Leisure to go out of business, the Council may not be repaid this loan.</p> | <p>Low</p> <p>0 – 250</p> |
| <p>Property Assets</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.</p> | <p>High</p> <p>0 - 4,000</p> |
| <p>Legal Issues</p> <p>It would be prudent for the Authority to make provision for an unfavourable</p> | <p>Medium</p> |

| Risk | Likelihood & Value £'000 |
|--|---|
| <p>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>100 – 2,000</p> <p>100 - 250</p> |
| Financial Risk Exposure | 840- 19,180 |

- 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 £19,180m 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 as set 2015/16 (£2.011m). In reviewing this figure based on current net budget requirement, we do not consider it prudent to adjust and as a result it will be held at the 2015/16 level..
- 3.6 **Plans for the General Fund Reserve 2016-2020** – 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) **Capital Projects Reserve** – This reserve holds future funding for the capital programme funded from revenue contributions
 - ii) **Council Elections Fund** – A sum of £30k is being set aside each year towards the costs of the District Elections.
 - iii) **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.
 - iv) **Destination Management**– This reserve is there to support the objectives of the Destination Management Plan by enhancing council assets that help to support and encourage tourism.

- v) **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.
- vi) **Dreamland Reserve** – Monies have been set aside to bolster the contingency for the Dreamland project.
- vii) **East Kent Services** – The year-end surpluses of East Kent Services are set aside in this reserve which the Council holds as accountable body.
- viii) **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.
- ix) **Environmental Action Plan** – This reserve holds funds that have been set aside to meet various improvements to public assets throughout the district.
- x) **General Fund Repairs** – This reserve makes provision for necessary essential repairs and maintenance and minor improvements to the Council's assets.
- xi) **Homelessness** – Service under-spends are held in this reserve to meet future homelessness needs.
- xii) **Housing Intervention** – This reserve is held to support the associated one-off costs (e.g. Compulsory Purchase Orders) of the housing intervention project.
- xiii) **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.
- xiv) **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.
- xv) **Maritime Reserve** – This reserve is to be used to fund potential future improvement works at the Port and Harbour and for income protection/maximisation works.
- xvi) **NDR Equalisation Reserve** – This reserve is to be used to offset significant variations in benefit subsidy. Due to the volatility of this activity and the tight financial constraints which preclude the budgets 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. This reserve will also support any potential shortfall in business rates, under the new business rates retention scheme.

- xvii) **New Homes Bonus** – Allocations of New Homes Bonus over budget were previously set aside in this reserve to support one-off projects, this is now in base and no surpluses are envisaged moving forward.
- xviii) **Office Accommodation** – This reserve may be used to support any office accommodation changes required as a result of restructuring.
- xix) **Pay and Reward** – This is to support the pay and reward related issues.
- xx) **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.
- xxi) **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.
- xxii) **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.
- xxiii) **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.
- xxiv) **Slippage Reserve** – This reserve is used to set aside sums at year end to meet ad hoc and specified liabilities on the General Fund which, due to timing difficulties, cannot be spent until after 31 March.
- xxv) **Unringfenced Grants** – Grant funding has been set aside in an earmarked reserve to be utilised in future years to help support the Economic Development and Community Development functions
- xxvi) **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.
- xxvii) **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.
- xxviii) **Waste Reserve** – Service under-spends will be set aside in this reserve to support future service enhancements and the costs of replacing the waste fleet.
- xxix) **HRA Properties Reserve** – This reserve was set up to support the purchase and refurbishment of HRA properties.

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

| PROPOSALS FOR THE GENERAL FUND EARMARKED RESERVES | Balance 31.03.2015 £'000 | 2015-16 Net Transfers £'000 | Balance 31.03.2016 £'000 | 2016-17 Net Transfers £'000 | Balance 31.03.2017 £'000 |
|--|---|--|---|--|---|
| Capital Projects Reserve | 954 | -954 | 0 | 0 | 0 |
| Council Elections Fund | 118 | -78 | 40 | 40 | 80 |
| Cremator and Cemeteries | 406 | -354 | 52 | 126 | 178 |
| Destination Management | 400 | -250 | 150 | 0 | 150 |
| Decriminalisation fund | 210 | -40 | 170 | 0 | 170 |
| Dreamland Reserve | 117 | 0 | 117 | -117 | 0 |
| East Kent Services Reserve | 303 | -203 | 100 | 0 | 100 |
| Economic Development & Regeneration | 198 | -98 | 100 | 0 | 100 |
| Environmental Action Plan | 162 | -162 | 0 | 0 | 0 |
| General Fund Repairs | 316 | -276 | 40 | 0 | 40 |
| Homelessness Fund | 276 | 0 | 276 | 0 | 276 |
| Housing Intervention Reserve | 172 | -100 | 72 | 0 | 72 |
| Information Technology | 311 | -100 | 211 | 0 | 211 |
| Local Plan | 418 | -113 | 305 | 0 | 305 |
| Maritime Reserve | 356 | -356 | 0 | 0 | 0 |
| NDR Equalisation Reserve | 1,205 | -1,030 | 175 | 0 | 175 |
| New Homes Bonus Reserve | 137 | -137 | 0 | 0 | 0 |
| Office Accommodation | 31 | -31 | 0 | 0 | 0 |
| Pay & Reward Reserve | 291 | -185 | 107 | 0 | 107 |
| Pensions Reserve | 412 | -220 | 192 | 0 | 192 |
| Priority Improvements | 478 | 0 | 478 | 0 | 478 |
| Renewal Reserve | 10 | -4 | 6 | 0 | 6 |
| Risk Management | 103 | 2,000 | 2,103 | -2,000 | 103 |
| Slippage Fund | 1,101 | -1,101 | 0 | 0 | 0 |
| Unringfenced Grants | 353 | -193 | 160 | -160 | 0 |
| VAT Reserve | 433 | -300 | 133 | 0 | 133 |
| Vehicle, Plant & Equipment | 227 | 350 | 577 | -577 | 0 |
| Waste Reserve | 13 | 0 | 13 | 0 | 13 |
| Total General Fund | 9,511 | -3,935 | 5,577 | -2,688 | 2,889 |

| | | | | | |
|------------------------|---------------|---------------|---------------|---------------|--------------|
| HRA Properties Reserve | 5,188 | 0 | 5,188 | 0 | 5,188 |
| Grand Total | 14,699 | -3,935 | 10,765 | -2,688 | 8,077 |

4.0 Proposed Reserve Levels

The levels of General Fund Reserves (General and Earmarked) recommended in this report for the financial year 2016-17 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.