

RESERVES AND BALANCES

1 INTRODUCTION

- 1.1 This report outlines current balances on all of the Council's reserves. It reviews the balances held in the General Fund Reserve, sets out proposals on parameters for the General Fund Reserve and recommends a level of contingency for the General Fund Reserve based on a risk assessment.

2 RECOMMENDATIONS

- 2.1 The terms of this report are noted.
- 2.2 The contingency level for the General Fund Reserve is set at £3.971m being 1.5% of the forecast budget in 2010-11.
- 2.3 There will be no automatic carry forward of unspent budget except for that permitted under the DMR scheme for Schools. Any unspent budget will be pooled and a report brought to the Council advising of the unspent balance as part of the annual accounts each year. Any proposals to utilise unspent budget will be considered taking account of the Councils priorities in terms of the corporate plan and service plans and the overall financial outlook.

3 DETAIL

- 3.1 Councils have powers to establish certain resource backed reserves and must maintain certain accounting reserves that are not resource backed and do not represent resources available for use by the Council. Councils need to be clear about the purpose of a reserve, how and when the reserve can be used, the arrangements for managing the reserve and the process for reviewing the relevance and adequacy of the reserve. The Council must also maintain a General Fund and can earmark balances for specific purposes within the General Fund.
- 3.2 It is considered good practice for the Council to review its reserves each year. The review of reserves should form part of the financial strategy and 3 year approach to managing the budget. The Council will wish to hold reserves as a working balance to manage the impact of uneven cash flows, as earmarked funds to fund specific activities or as a contingency for unexpected events. There are a number of factors the Council should take into account when considering the adequacy

of its reserves.

Resource Backed Reserves

- 3.3 The powers of councils to establish reserves are laid out in Schedule 3 of the Local Government (Scotland) Act 1975. These allow councils to establish a Renewal and Repairs Fund, Insurance Fund and Capital Fund. Councils can also establish a Useable Capital Receipts Reserve.
- 3.4 The Council has the following reserves and the following sections address the requirements outlined above. The Council does not have an insurance fund.

Reserve	Balance 31 March 2009 £000s
Renewal & Repairs Fund	544
Capital Fund	871
Useable Capital Receipts Reserve	2,762

- 3.5 The Renewal and Repairs Reserve was established to support funding of renewal and replacement of school equipment. Schools can only draw on the Renewal and Repairs Fund to the extent they have previously paid in to the Fund and contributions must be contained within schools devolved budgets. The balance and movement on the Renewal and Repairs Fund will be reported following the end of each financial year.
- 3.6 The Capital Fund was established to receive all capital receipts generated by the Council and can be used to support the capital plan or meet the principal repayments on loan charges. The Council decides as part of the budget process each year how it wishes to draw funding from the Capital Fund. Capital receipts of around £0.5m are forecast each year. These are allocated 50% to area committees and 50% to support the capital plan. All capital receipts will be paid into the Capital Fund. Based on the budget of £500,000 then it is estimated £250,000 will be drawn to support the capital plan and £250,000 will be available for area committees. Where area committees use this funding for revenue expenditure in accordance with criteria agreed in March 2008 then an equivalent amount of loans fund principal repayments will be charged to the Capital Fund to create the relevant budgetary provision. The balance and movement on the Capital Fund will be reported following the end of each financial year.
- 3.7 The Useable Capital Receipts Reserve relates to the accumulated unspent capital receipts from sale of council houses prior to transfer of the housing stock. The reserve forms part of the Council's Strategic Housing Fund and can only be used for investment in social housing.

The reserve will be used to support delivery of the Strategic Housing Investment Plan. Proposals to use the reserve are submitted to the Executive for approval as they are developed. A report is submitted to the Executive following the end of each financial year summarising income and expenditure and reviewing the balance on the reserve.

Accounting Reserves Not Backed By Resources

- 3.8 Councils are also required to establish certain reserves that are not backed by resources. They are required purely for accounting purposes and do not represent resources available for councils to utilise. The Pensions Reserve, Revaluation Reserve, Capital Adjustment Account and Financial Instruments Adjustment Account fall into this latter category of accounting reserves. The balance on each of these reserves at 31 March 2009 was as follows.

Reserve	Balance 31 March 2009 £000s
Revaluation Reserve	20,056
Capital Adjustment Account	77,039
Pensions Reserve	(32,517)
Financial Instruments Adjustment Account	(6,750)

- 3.9 The Revaluation Reserve represents the unrealised gains in the valuation of fixed assets. The balance on the Capital Adjustment Account is the difference between depreciation based on proper accounting practice and statutory charges for financing capital expenditure. The Pensions Reserve is the difference between pension costs based on proper accounting practice and payments made for pension costs. The Financial Instruments Adjustment Account represents the difference between gains and losses on borrowing and statutory capital financing charges.

General Fund Balance

- 3.10 There are a number of elements earmarked as balances within the General Fund and these are outlined below.
- 3.11 The Council has entered into long term PPP contracts for waste management and schools. Balances are held in the General Fund Reserve and described as PPP Smoothing Funds to smooth out the budgetary impact of differences in the profiles of income and expenditure on the PPP projects over the long term life of these contracts. At 31 March 2009 this amounted to £14.639m.
- 3.12 Income collected from council tax on second homes can only be used for investment in social housing. The current balance represents

income collected from 2005-06 to 2008-09 and amounted to £6.032m at 31 March 2009. It forms part of the Council's Strategic Housing Fund. The Council agreed a parameter for this element of the reserve being £4.8m or around 1.8% of net expenditure. Proposals to access this funding have been slow at coming forward reflecting a tightening of the funding regime for social housing. Although a number of projects have been agreed for funding they had not drawn down any significant funds at 31 March 2009. This led to the parameter of 1.8% £4.8m being exceeded. It is likely a similar situation will arise at 31 March 2010. However the Council should retain the parameter as a working target. The Useable Capital Receipts Reserve also forms part of the Strategic Housing Fund giving a total Fund of £8.794m. The purpose and monitoring arrangements for the Strategic Housing Fund are outlined in paragraph 3.7 above.

- 3.13 There have been occasions where grant income or contributions are received in one financial year and not spent until the following year. Unless the grant or contribution is a specific grant then the unspent grant requires to be held in the General Fund at the year end and carried forward into the next financial year. At 31 March 2009 this amounted to £2.012m. The Council agreed a parameter to try and ensure grant income and contributions carried forward should not exceed 1% of net expenditure. This would amount to £2.6m. This parameter was met at 31 March 2009.
- 3.14 There are occasions where budgetary provision is carried from one year to another. Proposals for this are approved as part of the annual accounts each year. At 31 March 2009 this amounted to £3.659m. The Council agreed a parameter to try and ensure that any unspent budget carried forward should not exceed 1% of net expenditure. This would amount to £2.6m.
- 3.15 Expenditure against earmarked balances is monitored throughout the financial year. Appendix 1 shows the earmarked balances currently forecast to be unspent at 31 March 2010. The Appendix identifies the unspent amount of each earmarked balance at 31 March 2010. This excludes the amounts ring fenced for social housing and the PPP smoothing funds. The amounts detailed in Appendix 1 relate to unspent grants or external contributions or funding that has already been agreed for earmarking to meet specific corporate priorities.
- 3.16 From 31 March 2010 and in future it is proposed that there is no automatic carry forward of unspent budget except for that permitted under the DMR scheme for Schools. Any unspent budget will be pooled and a report brought to the Council advising of the unspent balance as part of the annual accounts each year. Any proposals to utilise unspent budget will be considered taking account of the Councils priorities in terms of the corporate plan and service plans and the overall financial outlook.

- 3.17 As part of the budget approved for 2009-10 the Council agreed to fund certain costs from the General Fund Reserve either directly or by allowing departments to carry forward underspends from one year to offset budget reductions required in the following year. At 31 March 2009 this amounted to £1.673m and this was applied to balance the 2009-10 budget.
- 3.18 The items outlined above represent the earmarked funds within the General Fund Reserve. The table below summarises the position as at 31 March 2009.

	£000s
PPP Smoothing Funds	14,639
Ring Fenced for Social Housing	6,032
Grant Income and Contributions Carried Forward	2,012
General Earmarked Sums	3,659
Funding Committed to Balance Future Years Budget	1,673
Total Earmarked	28,015

- 3.19 The total General Fund Reserve as at 31 March 2009 amounted to £32.627m. After adjusting for the earmarked funds outlined above this leaves a free balance of £4.612m.
- 3.20 The Council has approved supplementary estimates amounting to £0.286m during 2009-10 to be funded from the General Fund Reserve and the effect of this is to reduce the free General Fund Reserve to £4.326m. The supplementary estimates comprise £70,000 to cover the review of scheme of Community Councils and £216,000 for the detailed design stage of Process for Change.
- 3.21 At the time of writing the forecast outturn for 2009-10 is a projected overspend of £1.9m. Within that the underlying forecast overspend has reduced from £2.4m in September to £1,187k at the end of December. The impact of the moratorium has had a significant impact on the forecast outturn. However the extreme winter conditions have led to a forecast overspend on winter maintenance of £750k. Even with this there is still a degree of confidence that the final outturn for the year can be brought in line with budget. This is based on expenditure to date being £1,390k below budget and the significant impact of the moratorium over the last 3 months continuing.
- 3.22 The free balance in the General Fund Reserve at 31 March 2009 after allowing for supplementary estimates during 2009-10 is £4.326m. At this stage measures are in place to ensure the outturn for 2009-10 is contained within budget. On this basis the free balance in the General Fund Reserve that would otherwise be carried forward to 2010-11 is £4.326m. There are other factors that will affect the balance on the

General Fund Reserve.

- 3.23 The Council has agreed to proceed with the Workforce Deployment and Customer Management project from Process for Change. The net costs for these projects in 2010-11 and 2011-12 are £874,000 and £254,000 respectively. However capital costs of £636,000 have been identified and will be funded by prudential borrowing. This reduces the 2010-11 revenue cost to £238,000 and this requires to be covered by the General Fund for 2010-11. The estimated cost of £254,000 for 2011-12 can be built in to the budget for that year.
- 3.24 The Council has also agreed a restructuring of senior management at director and head of service levels. The redundancy and retirement costs arising from this are not yet known. The annual saving from the revised structure is £370,000 per annum. Normal practice would be to achieve a pay back on the retirement and redundancy cost within 3 years.
- 3.25 The Council has recently received a repayment of VAT from Her Majestys Revenue and Customs (HMRC) of £253,000 net of anticipated costs. This will be held in the General Fund and increases the free balance.
- 3.26 The table below shows the free balance in the General Fund Reserve after taking account of the above. There are two variations depending on whether redundancy and retirement costs are equivalent to 2 or 3 years of the annual savings from the senior management restructuring.

	Costs Equal 2 Year Pay Back £000s	Costs Equal 3 Year Pay Back £000s
Current free balance on General Fund Reserve	4,326	4,326
Process for Change costs from Customer Management and Workforce Deployment 2010-11 – Net of capital costs funded by prudential borrowing	-238	-238
Management restructuring costs	-740	-1,110
Savings from management restructuring 2010-11	+370	+370
VAT repayment from HMRC	+253	+253
Projected free balance on General Fund Reserve 31 March 2011	3,971	3,601
Savings from management restructuring 2010-11		+370
Projected free balance on General Fund Reserve 31 March 2012		3,971

- 3.27 Based on the agreed contingency level of 1.5% of net expenditure then the target for the free balance in the General Fund Reserve is £3.971m. If the redundancy and retirement costs from the senior management restructuring equate to a payback within 2 years then the 1.5% contingency target for the General Fund Reserve is achieved at 31 March 2010. If the costs equate to a 3 year payback then the 1.5% contingency target for the General Fund Reserve is achieved at 31 March 2011. The table demonstrates that there are no funds within the General Fund Reserve that can be used to provide support to the 2010-11 budget and that there is no need to provide for a top up to the General Fund Reserve as part of the 2010-11 budget.

Review and Risk Assessment

- 3.28 Assessing the adequacy of reserves should take account of the strategic, operational and financial risk facing the Council and should consider both internal and external factors. Appendix 2 to this report identifies the range of issues in terms of budget assumptions and financial standing and management that should be considered in assessing the level of reserves.
- 3.29 There are 15 categories included in the risk analysis and 7 have been assessed as low with 4 medium/low and 4 medium. This compares to 9 low, 2 low/medium, 2 medium and 2 medium/high at the last review as part of the 2009-10 budget. There are now no medium/high risks. The medium risks relate to cost pressures, demand led pressures, strategic risks, operational risks and track record in budget management.
- 3.30 Based on the above it is recommended that the contingency for the General Fund reserve should be retained at 1.5%.
- 3.31 Risks in terms of capital projects can be partially managed by using capital receipts and managing the overall capital plan. In terms of cash flow management there are substantial earmarked reserves that in the short term can be used to manage overall cash flow.

4 CONCLUSION

- 4.1 The report outlines the overall reserves and balances for the Council covering the purpose and level of each reserve. Finally a risk review of the adequacy of reserves has been carried out and a target level for the general contingency recommended.

IMPLICATIONS

Policy – Sets out policy for managing reserves

Financial – Complies with guidance to review reserves each year

Personnel – None

Legal – None

Equal Opportunities - None

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**EARMARKED BALANCES IN GENERAL FUND FORECAST AS UNSPENT AT 31
MARCH 2010 – APPENDIX 1**

Department	Earmarking	Balance Forecast As Unspent 31 March 2010		Comment
		£000s	£000s	
Corp Services	eCare - A&B Contribution	54		
Corp Services	ICT Topslice (MGF)	295		
Corp Services	CCTV Maintenance	92		
Corp Services	Money Management	85		
Corp Services	Home Safety Unit	139		
Corp Services	MGF Land & Property (DNAS)	27		
Corp Services	Smart Card	175		
Corp Services	eCare	20		
Corp Services	Food Safety Management Programme	27		
Corp Services	Licensing Standards	340		
Corp Services			1,254	
Comm Services	Oban Community Sports Field	6		
Comm Services	Social Work – Care First Funding	23		
Comm Services	School Estate Strategy	30		
Community Services			59	

Dev Services	Campbeltown Area Regeneration Scheme	129	Amount committed to Campbeltown Town Centre & Waterfront Project
Dev Services		129	
Operational Services	Red Gauntlet	18	
Operational Services	Mercury Abatement	79	Amounts held to cover future maintenance
Operational Services		97	
Total		1,539	

Risk Assessment for Review of Reserves Appendix 2

Factor	Comment	Assessment
Inflation Rates	Inflation has been low for 2009-10. An estimate of inflation tailored to individual costs has been prepared although a significant proportion has been removed as an efficiency saving. The budget at this stage contains no provision for the pay award for local government staff. In broad terms an overall variation of 1% in inflation would change the Councils overall costs by around £2m.	Low (2009-10 Low)
Interest Rates	The Council has a large proportion of its borrowing secured at fixed rates. Surplus funds are invested and the rates of interest earned reflect current market conditions. Borrowing is being managed to reduce surplus cash available for investment subject to working capital/cash flow requirements. This reduces risk exposure on surplus funds. Current forecasts of interest rate are based on advice from our treasury advisors. Current investment rates are so low there is little scope for them to reduce any further.	Low (2009-10 Low)
Cost pressures	Cost pressures have been reviewed as part of the service planning and budget preparation process. The cost pressures included in the service plans and draft budget take account of the requirement to fund existing levels of service provision. The one cost pressure to highlight relates to school meals income where a trend has emerged of falling income levels. An initial estimate of a reduction of £300,000 was made but this has been reduced back to £150,000 based on the actual reduction to the end of October. There is a higher risk that this cost pressure provision will not be adequate and this increases the risk assessment for this category from low.	Medium (2009-10 Medium)
Demand led pressures	The main demand led pressures over the last few years have related to social work services for children, home care and residential care placements for older	Medium (2009-10 Medium/High)

Risk Assessment for Review of Reserves Appendix 2

Factor	Comment	Assessment
	people and winter maintenance on the road network. The cost pressures for children and families provide sufficient budget for the current level of service and takes account of growth to date but does not provide for an ongoing increase in demand for service. Provision has been made for demand growth in social work services at 2.3% and this reflects the population projections for 2010-11. Winter maintenance budget remains at the same level as 2009-10 and is predicated on 2010-11 being an exceptional year.	
Financial risks	The Council has reduced surplus funds invested and this has reduced exposure to risks associated with money market deposits. It retains a working balance of £20m to meet cash flow needs. Investments are managed based on the credit worthiness of agreed counterparties based on credit scores of recognised agencies. This should avoid having to borrowing in an unplanned way from the money markets.	Low (2009-10 Low)
Strategic risks	The Council has reviewed the strategic risk register and reflected strategic risks in its corporate and service planning process.	Medium (2009-10 Medium)
Operational risks	Operational risk registers are now held in Pyramid and formally reviewed each quarter. Service plans and budget have been prepared to reflect current risks.	Medium (2009-10 Medium)
Efficiency/budget savings	All budget savings are removed from budgets prior to allocation of budgets to managers. Monthly budget monitoring should identify issues.	Low (2009-10 Low)
General financial climate	The finance settlement is known for 2010-11 and the draft budget is based on that. A prudent approach to estimating income from council tax has been taken. Risks arising from inflation, interest rates, cost pressures and demand led pressures have been outlined above. In terms of the general financial climate the biggest risk is around future funding for public services and the impact this might have	Low (2009-10 Low)

Risk Assessment for Review of Reserves Appendix 2

Factor	Comment	Assessment
	on funding and the budget. This is expected to impact on the 2011-12 budget and will be considered next year but it is worth bearing in mind.	
Availability of contingency funds	The Council currently has sufficient contingency funds to meet its target. The proposals on the budget do not have a negative impact on that. The main risk factors are around the 2009-10 outturn and any impact that may have and also the amount and phasing of costs related to the organisational restructuring and process for change implementation that are being funded from the General Fund. However these risks are offset by the extent to which there are substantial earmarked reserves that could be deployed to provide a contingency if required.	Low/Medium (2009-10 Low)
Overall financial standing	The Council has managed to achieve its contingency target in previous years. Actual costs are normally contained within budget. Borrowing costs are largely fixed and exposure to changes in investment rates for surplus cash are minimised. In addition to the contingency there are significant earmarked funds. The planning and budget process has identified cost pressures and risks. In overall terms the risks from the overall financial standing of the Council are low.	Low
Track record in budget management	The Council has a good track record of containing expenditure within budget. The risks to this factor are around the final outturn for 2009-10 and in particular can the current overspend be brought in line with budget and the final level of costs for winter maintenance.	Low/Medium (2009-10 Low)
Financial information and reporting arrangements	Revenue and capital budgets are monitored on a monthly basis with budget allocated to responsible managers. However there have been cost overruns on some major capital projects.	Low/Medium
Insurance cover	The Council has adequate insurance cover.	Low
Internal controls	The statement of internal controls	Low/Medium

Risk Assessment for Review of Reserves Appendix 2

Factor	Comment	Assessment
	identifies a generally adequate control framework although there are areas for improvement. An audit plan is approved and delivered each year to monitor internal controls. The Council's Audit Committee is active and complies with most aspects of good practice.	