

# Revenue and Capital Reserves Policy

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## Document Control

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<b>Policy Author(s) and Owner</b>	Jonathan Belford
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## 1. Purpose Statement

- 1.1 The requirement for financial reserves is acknowledged in statute. Section 93 of the Local Government Finance Act 1992 requires Scottish authorities, in calculating the council tax, to take into account 'any means by which those expenses may otherwise be met or provided for'. This includes reserves.
- 1.2 The purpose of the policy is to explain why reserves are retained and to quantify the value of reserves that the Council should retain, enabling stakeholders to understand the reasons for retaining reserves.
- 1.3 The objective of the policy is to provide a framework that the Council should measure itself against when setting the budget to satisfy itself that the retention and holding of reserves is appropriate to the operating environment and risks the Council faces.

## 2. Application and Scope Statement

- 2.1 In Scotland there are explicit statutory powers under schedule 3 of the Local Government (Scotland) Act 1975 permitting certain local authorities to establish a renewal and repair fund, and insurance fund and a capital fund alongside a requirement to maintain a general fund (s.93 of Part VII of the Local Government (Scotland) Act 1973). Separate reserves can be established in Scotland only where there are explicit statutory powers. Scottish local authorities may however ' earmark' specific parts of the General Fund reserve.
- 2.2 There are other safeguards in place that help to prevent authorities over-committing themselves financially. These include:
  - The balanced budget requirement (Local Government Finance Act 1992 s93);
  - Legislative requirements for each authority to arrange for the proper administration of their financial affairs and that the chief finance officer has responsibility for the administration of those affairs (s.95 of the Local Government (Scotland) Act 1973);
  - The requirements of the Prudential Code;
  - Auditors will consider whether audited bodies have established adequate arrangements to ensure that their financial position is soundly based.
- 2.3 Whilst it is primarily the responsibility of the authority and its chief financial officer to maintain a sound financial position, external auditors will, as part of their wider responsibilities, consider whether audited bodies have established adequate arrangements to ensure that their financial position is soundly based. However, it is not the responsibility of auditors to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general.
- 2.4 CIPFA's Prudential Code requires the chief finance officers in authorities to have full regard to affordability when making recommendations about the authority's future capital programme. Such consideration includes the level of long-term revenue commitments. Indeed, in considering the affordability of its capital plans, the authority is required to consider all of the resources available to it/estimated for the future, together with the totality of its capital plans and revenue forecasts for the forthcoming year and the following two years. There is a requirement for three-year revenue forecasts across all authorities and this is achieved through the 5-year

financial model. This provides ability to focus on the levels of reserves and application of authority balances and reserves.

- 2.5 Within the existing statutory and regulatory framework, it is the responsibility of the chief financial officer to advise local authorities about the level of reserves that they should hold and to ensure that there are clear protocols for their establishment and use. Reserves should not be held without a clear purpose.
- 2.6 CIPFA and the Local Authority Accounting Panel do not accept that there is a case for introducing a generally acceptable minimum level of reserves. Authorities on the advice of their chief finance officers should make their own judgements on such matters taking into account all relevant local circumstances. Such circumstances will vary between authorities. A well- managed authority, for example, with a prudent approach to budgeting should be able to operate with a level of general reserves appropriate for the risks (both internal and external) to which it is exposed. In assessing the appropriate level of reserves, a well-managed authority will ensure that the reserves are not only adequate but also are necessary.
- 2.7 Imposing a generally applicable minimum level would also be counter to the promotion of local autonomy and would conflict with the financial freedoms introduced for Scottish authorities in the Local Government in Scotland Act 2003. Nor is it considered appropriate or practical for CIPFA, or other external agencies, to give prescriptive guidance on the minimum (or maximum) level of reserves required, either as an absolute amount or a percentage of budget.
- 2.8 In order to secure strong governance for the Council and a sustainable future, the principles of good legislative and best practice are important to underpin our approach. Further, in order to secure the confidence of our Bond investors and to retain our credit rating, the management of our reserves and balance sheet is an important check. Outline who is affected by the policy, and who/what it applies to;

### **3. Responsibilities**

- 3.1 The Chief Officer – Finance is responsible for managing this policy, including providing advice and guidance to the Extended Corporate Management Team, Council and staff, in relation to the specific elements of the policy.
- 3.2 Breach or misuse of the policy is likely to have adverse consequences for financial planning in subsequent years and may require budget holders to adjust and adapt to revised financial controls during the year should the Chief Officer – Finance consider it necessary.
- 3.3 Non-compliance with the policy can be reported through service finance contacts, the Council’s Finance Operations Manager or directly to the Chief Officer – Finance.
- 3.4 If you have feedback or suggestions for improvement in this policy, then please contact the Finance Operations Manager or Chief Officer – Finance.

### **4. Supporting Procedures & Documentation**

- 4.1 This document aims to provide an over-arching policy that is applicable to the year ahead and is included in the budget report for the purposes of being considered at the time of budget setting.

- 4.2 [Financial Regulations](#) must be read in conjunction with this policy.

#### **The General Fund (excluding Housing Revenue Account Reserves)**

- 4.3 It has previously been agreed by the Council that the General Fund will retain an uncommitted balance at a level based on a risk assessment of the factors impacting our finances; at 31 March 2020 this amounted to £12.0 million.
- 4.4 The purpose of this reserve is to provide for any unexpected expenditure that cannot be managed within existing budgets. Such expenditure would be one-off and resulting from an extraordinary event. The minimum amount for this reserve on a risk basis should be £12.0m, and the recommended amount is £12.0m.
- 4.5 The General Fund should be set at a prudent and not excessive level, as holding high level of reserves can impact on resources and performance. It is important to regularly consider the level of risks that are known and consider the potential internal and external factors that may impact on the ability of the Council to delivery its strategic objectives, and to be financially prepared.
- 4.6 As the net budget position changes the level of General Reserve must be monitored to ensure the minimum level is maintained. This is particularly relevant where revenue carry forwards are identified as part of the year-end process.
- 4.7 Section 8, below, details the elements that make up the current General Fund uncommitted reserve and the levels of risk attached to each of these elements. These are indicative and may not be exhaustive as new risks emerge.

#### **The General Fund - Earmarked Reserves**

- 4.8 Unlike the General Fund uncommitted balance, earmarked reserves have been identified for specific areas of expenditure where there are anticipated costs that can only be estimated. It is therefore prudent for the authority to identify such areas of expenditure and set aside amounts that limit future risk exposure.
- 4.9 Such expenditure usually arises out of specific projects and work that continues over a period of more than one year, where identifiable risks exist, where an specific Council policy exists (such as the Devolved Education Management scheme) or where accounting treatment dictates that sums must be treated as such (for example unspent grants and contributions that have repayment conditions).
- 4.10 The annual budget report provides a summary of the earmarked reserves and the anticipated year-end balance.
- 4.11 Expenditure relating to earmarked reserves must specifically relate to the purpose of the reserve, and new earmarked reserves can be created, normally occurring at the end of the year as part of the year-end review processes or during the annual budget setting process.

#### **The Housing Revenue Account**

- 4.12 The Council, as a social landlord, has a statutory duty to account for local authority housing provision as defined by the Housing (Scotland) Act 1987.
- 4.13 The uncommitted balance held on the HRA is necessary for the purpose of managing the changing needs of the tenants and the housing stock that they live in. The value of balances is included in to the 30 year financial modelling and enables the Council to plan and address peaks in lifecycle and maintenance costs of the housing stock.

- 4.14 Housing rent pays for the upkeep of the properties and therefore it is vital that there is sufficient funding in place to support the investment required, the HRA cannot be subsidised by the General Fund.

#### **The Housing Revenue Account – Earmarked Reserves**

- 4.15 Like the General Fund, it is common for specific activities to impose a financial commitment on the HRA. For this reason, the Council earmarks sums from within the HRA balances. These are often repairs based, where work has been ordered but not yet started. This ensures that the HRA meets the obligations.
- 4.16 Expenditure relating to earmarked reserves must specifically relate to the purpose of the reserve, and new earmarked reserves can be created, normally occurring at the end of the year as part of the year-end review processes or during the annual budget setting process.

## 5. Policy Statement

- 5.1 This policy imposes on the Council the parameters in which reserves are to be managed, creating an understanding of the obligations that it has a duty to meet, and ensuring that the organisation is aware of and prepared for financial uncertainty that exists in operating a large complex Council.

## 6. Definitions

- 6.1 When reviewing the medium-term financial plans and preparing the annual budgets authorities should consider the establishment and maintenance of reserves. These can be held for four main purposes:
- A working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves.
  - A contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves.
  - A means of building up funds often referred to as earmarked reserves, to meet known or predicted requirements; earmarked reserves are accounted for separately but remain legally part of the general reserve.
  - The economic climate and the safety of the Council's financial assets. This would link closely with the Council Treasury Management and Prudential Code Strategies.
- 6.2 Authorities also hold other reserves that arise out of the interaction of legislation and proper accounting practice. These reserves, which are not resource-backed and cannot be used for any other purpose, are listed below:
- The Pensions Reserve
  - The Revaluation Reserve
  - The Capital Adjustment Account
  - The Available-for-Sale Financial Instruments Reserve
  - The Financial Instruments Adjustment Reserve
  - Accumulated Absences Adjustment Account

- 6.3 Other such reserves may be created in future where developments in local authority accounting result in timing differences between the recognition of income and expenditure under proper accounting practice and under statute or regulation, such as the Capital Grants Unapplied Account.
- 6.4 In addition, authorities may hold a Capital Fund. This reserve holds the proceeds from the sale of assets and can only be used for capital purposes in accordance with the regulations. The Council maintains a Capital Fund.
- 6.5 For each earmarked reserve held by the authority there should be a clear protocol setting out:
- The reason for/purpose of the reserve
  - How and when the reserve can be used
  - Procedures for the reserves management and control
  - A process and timescale for review of the reserve to ensure continuing relevance and adequacy
- 6.6 When establishing reserves, authorities need to ensure that they are complying with the Code of Practice on Local Authority Accounting and the need to distinguish between reserves and provisions.

## 7. Risk

- 7.1 Fundamentally this policy is designed to mitigate financial risk and the risk that the Council will have insufficient funds to meet expenditure that might arise.
- 7.2 Any Council recommendations that change the planned use of reserves reported within the Annual Budget will take account of the need for service delivery balanced against the need to retain prudent levels of reserves.
- 7.3 The significant risks that have been considered, but which will also be kept under review are:
- The anticipation of considerable cost pressures, pay and prices, demand and need, as well as changes resulting from national policy, such as Welfare Reform, or a lower level of priority than other public services, all of which may have a significant impact on the need for use of reserves.
  - The potential impact of further changes to funding and financial resource availability from the current financial climate.
  - The instability of the Financial Markets means that the investments we make with balances are currently exposed to greater risk.
  - The challenges of the current 5-Year financial model and the extent to which the redesign of services will have the desired impact on delivering a balanced and sustainable revenue budget position.
- 7.4 The level of Reserves is kept under review. The Council receives reports on the levels of reserves as part of the annual budget setting process, the preparation of the annual accounts and at other times should circumstances require it.
- 7.5 The Council must balance the retention of reserves and absolute need for these with the retention of too high a value, potentially depriving services or available funding. This is considered as part of the annual budget setting process.
- 7.6 The policy also mitigates compliance and reputational risks, in relation to the legal requirement to meet obligations to calculating and setting council tax, to establish

and maintain specific reserves. Failure to do so will draw attention from auditors, stakeholders and other scrutiny bodies.

- 7.7 The policy ensures that operational risk, in the event of extreme unplanned circumstances can be maintained to deliver vital services to the citizens of Aberdeen.

## 8. Policy Performance

- 8.1 The policy performance is determined by the Council’s retention, accumulation and use of reserves. The Council holds reserves for both specific purposes and as a means of mitigating financial risk, particularly that which is unknown.
- 8.2 The financial risk matrix shown below provides the basis for measuring the Council performance on the management of uncommitted reserves in the General Fund. The range and recommended values provide the Council with a reference point when setting the budget for the year ahead.

Risk	Impact	Probability	Min	Max	Recom-
			£m	£m	mended £m
Major incident(s), Unbudgeted expenditure or lost income (e.g. pandemic)	Potential unplanned expenditure in support of specific circumstances	Single incident amounting to less than 1% of net budget – HIGH Single incident amounting to more than 1% of net budget - MEDIUM Multiple incidents amount to over 1% of net budget – LOW	6.0	15.0	6.0
Major disaster (e.g. natural)	Service delivery affected and resources diverted (e.g. through buildings being inaccessible and disaster recovery plan being actioned)	Based on historic experience & Bellwin Scheme, the Council must meet 0.2% of net expenditure before application – VERY LOW	1.0	4.0	1.0
Counterparty failure	If invested balances were tied up in a process to recover them there would be an immediate	Based on treasury policy and practices – VERY LOW	1.0	5.0	1.0

	impact on the revenue budget as funds at additional cost were obtained.				
General financial climate	Wider knock-on effects of financial market changes, recession and / or lower growth and the consequential impact on UK and Scottish budgets.	Single year settlement, UK Budget not being set until 3 March 2021, uncertain future impact of devolved tax powers on Scottish Budget, unprotected nature of local government sector - MEDIUM	5.0	10.0	5.0
<b>TOTAL</b>			<b>12.0</b>	<b>34.0</b>	<b>12.0</b>

8.3 Reserves are monitored and reported as part of the quarterly financial performance reporting and included in both the budget setting reporting and annual accounts.

## 9. Design and Delivery

- 9.1 This policy is aligned to the Target Operating Model (TOM) and strategic objectives contained within the LOIP in the following ways:
- It supports the development and maintenance of a scheme of financial delegation, which is consistent with the commissioning model and increased community empowerment.
  - It provides oversight of the stewardship of the council to ensure that the authority puts in place effective internal financial controls covering codified guidance, budgetary systems, supervision, management review and monitoring, physical safeguards, segregation of duties, accounting procedures, information systems and authorisation and approval processes, cash flows borrowings and investments and financial systems.
  - It supports the Chief Officer – Finance in their role, responsible for the financial governance and scrutiny in the organisation

## 10. Housekeeping and Maintenance

- 10.1 This policy will be reviewed annually.
- 10.2 During the year changes may occur in the 5-Year financial model, which affect this policy. Such changes will be monitored by the Chief Officer - Finance and reported to the Council.
- 10.3 The Council's financial systems hold details of the reserves and transactions will be applied with having due consideration of this policy.

## **11. Communication and Distribution**

- 11.1 This policy is approved annually as part of the budget setting process and is circulated widely to finance staff and service staff through budget holder meetings and distribution of budget packs to budget holders.

## **12. Information Management**

- 12.1 The information generated by the application of the policy will be managed in accordance with the Council's Corporate Information Policy and supporting Procedures.