

Earmarked Reserves and General Balances Policy Statement 2022/23

Introduction

1. This paper sets out the Council's policies underpinning the maintenance of a level of general balances and earmarked reserves within the Council's accounts.

Statutory Position

2. A local authority is not permitted to allow its spending to exceed its available resources so that overall it would be in deficit. Sections 32 and 43 of the Local Government Finance Act 1992 require authorities to have regard to the level of balances and reserves needed for meeting future estimated future expenditure when calculating the council tax requirement.
3. Balances and reserves can be held for three 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 forms part of general balances;
 - A means of building up funds often referred to as earmarked reserves, to meet known or predicted liabilities
4. This policy statement is concerned with general balances and earmarked reserves as defined above.

Purpose of balances and reserves

5. The Council maintains general balances in order to provide a contingency against unplanned or unexpected events.
6. Although there is no recognised official guidance on the level of general balances to be maintained, the key factor is that the level should be justifiable in the context of local circumstances. The council's external auditor comments on the level of balances and reserves as part of the annual audit of the Council's financial position. Financial regulations require Council to decide on the level of general balances it wishes to maintain before it can decide the level of council tax. This will be done as part of the annual budget setting process.
7. Whilst general balances are unallocated, earmarked reserves are held for a specific purpose and to mitigate against potential future known or predicted liabilities.

Planned use of balances and reserves

8. Planned use of earmarked reserves or general balances in setting a budget each year is an acceptable approach subject to the level of reserves being adequate and necessary, albeit recognising that it is only a one-off measure. Any planned use of, or contribution to, earmarked reserves or balances must be included as part of the budget setting process each year.
9. In accordance with the Council's Financial Procedure Rules, any new reserves or a change in the purpose of earmarked reserves requires Cabinet approval. Contributions to or use of earmarked reserves is reported to Cabinet as part of the monthly Business Management & Monitoring Report Those greater than £1m require endorsement by Cabinet.

Level of General Balances

10. It is considered prudent to maintain a level of balances commensurate with risk, and a risk assessment is undertaken annually by the Section 151 officer (Director of Finance), as part of the budget setting process. CIPFA's Financial Resilience Index provides information on the level of general balances for all authorities. The average percentage of net revenue budget held for general balances by County Councils in 2019/20 was 5.1%.
11. The risk assessment for 2022/23 has determined that balances should be held at £28.9m, compared to £28.8m for 2021/22. This is equivalent to 5.6% of the proposed net revenue budget for 2022/23 and equates to around three weeks net expenditure. The assessed risk for 2022/23 is similar to that for 2021/22 reflecting the changing risk environment that has emerged as a result of the COVID-19 pandemic. Balances will be maintained at minimum of the risk assessed level for 2022/23, or more depending on the 2021/22 outturn position. Details of the risk assessment are set out as annex 1 to this policy statement.
12. Based on the latest 2021/22 Business Management & Monitoring Report to Cabinet in November 2021, the expected level of balances at 31 March 2022 is currently £32.0m. The proposed MTFS includes an annual contribution to balances of £1.0m each year to replenish any use of balances from the previous year. Given the expected level of balances at 1 April 2022 is expected to be £33.0m, £4.1m more than the risk assessed level, it is proposed that a contribution of £3.0m is made to the Capital Reserve to contribute towards the programme and schemes set out in Paragraph 16 below.

Earmarked Reserves

13. Annex 2 sets out the actual level of earmarked reserves at 31 March 2021 and expected level at 31 March each year to 2026 as well as a description of each reserve. Issues of significance are set out in the paragraphs below.

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14. Excluding schools, earmarked reserves are forecast to be £134.8m at 1 April 2022, reducing over the medium term to £92.9m by 2025/26.
15. This position does not take into account an estimated deficit on the DSG Reserve in relation to High Needs of £137.4m by 2025/26.

Use of existing reserves

16. The proposed budget for 2022/23 includes the use of £14.0m one-off funding available from earmarked reserves and general balances to contribute to the Capital Reserve to meet the costs of the 20 MPH Speed Limit Programme (£8m) and the Zero Emission Buses Regional Areas (ZEBRA) Schemes (£6m):
 - £7.0m contribution from the Budget Priorities Reserve
 - £1.0m contribution from the Budget Equalisations Reserve
 - £3.0m contribution from the Council Tax Collection Fund reserve

Capital Reserve

17. The Capital Reserve includes funds held to meet the cost of borrowing to finance the capital programme. The proposed budget includes an annual contribution to the reserve of £5.3m from 2022/23 to meet up to £90m of borrowing to fund the capital programme.

Demographic Risk Reserve

18. In light of the significant pressures relating to High Needs and other budgets with demographic volatility a demographic risk reserve was created in 2019/20. The existing MTFs includes an annual contribution to the reserve of £4.0m from 2022/23. The forecast reserve totals £25.0m by 2025/26. This reserve will in part offset the impact of carrying the negative DSG reserve on the Council's cashflow and improve the financial resilience position.

Budget Priorities Reserve

19. The existing MTFs includes an annual budgeted contribution of £1.8m to the Budget Priorities reserve. This reserve is to fund the priorities of the Council. It is proposed that £7.0m of this reserve is transferred to the Capital Reserve to contribute towards the cost of the programmes referred to in paragraph 16 above.
20. As part of the Provisional Local Government Finance Settlement announced in December 2021, an additional £6.8m of one-off funding will be available in 2022/23. The proposed budget includes a contribution to the Budget Priorities Reserve of £5.4m to be used in 2022/23 for projects which align with the nine priorities of the administration.

Budget Equalisation Reserve

21. The Budget Equalisation Reserve is used to smooth the timing differences between funding changes and emerging pressures over the period of the MTFS. The level of reserve is sufficient over the medium term and it is proposed to transfer £1.0m of the reserve in 2022/23 to the Capital Reserve to contribute towards the cost of the programmes referred to in paragraph 16 above.

COVID-19 Reserve

22. The balance of unused COVID-19 funding available at the end of 2021/22 is expected to be £23.4m. Section 4.2.1 of this report sets out the proposed use of the reserve in 2022/23 and over the medium term. In total £20.1m is proposed to be used by 2025/26, leaving an uncommitted balance of £3.3m available for unplanned or unexpected costs.

Council Tax Collection Fund Reserve

23. Due to the anticipated impact of the COVID-19 pandemic, the Council Tax Collection Fund Reserve was created in 2020/21 to manage an anticipated deficit on the district and city council's collection funds, of which the county council's share is approximately 90%. The reserve was not required in 2021/22 and latest estimates suggest there is more in this reserve than may be required over the medium term. Therefore, it is proposed that £3.0m is transferred to the Capital Reserve to contribute towards the cost of the programmes referred to in paragraph 16 above.

Dedicated Schools Grant (DSG) Unusable Reserve

24. The School and Early Years Finance (England) Regulations 2020 stipulate that a deficit on the DSG must be carried forward to be funded from future DSG income unless permission is sought from the Secretary of State for Education to fund the deficit from general resources.
25. Further clarification of the accounting treatment for deficit DSG balances was provided by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2020. These stipulated that where a local authority has a deficit in respect of its school budget for a financial year beginning on 1st April 2020, 2021 or 2022, the authority—
- (a) must not charge to a revenue account an amount in respect of that deficit; and
 - (b) must charge the amount of the deficit to an account established, charged and used solely for the purpose of recognising deficits in respect of its school budget
26. As a result of this, an unusable reserve has been created on the balance sheet to hold the negative balance. This is different to the previous accounting treatment where the negative balance was held within the Council's total Earmarked Reserves. Unusable reserves are usually created to hold

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accounting adjustments that cannot be charged to the general fund and have no cash value. The new DSG unusable reserve is unique in that it the deficit balance has a real impact on the Council's cash balance.

27. As at 31 March 2021, the DSG Unusable Reserve had a negative balance of £11.5m of which a negative balance of £19.0m related to High Needs DSG. This reserve will continue to increase in deficit over the MTFS period and is forecast to be in deficit by £35.4m at 31 March 2022. Based on current levels of demand, it is anticipated that the reserve could reach a deficit of £137.4m by the end of 2025/26.
28. The regulations which require the negative balance to be held in an unusable reserve come to an end on 1 April 2023. If a solution is not found or extension of the regulations is not granted the balance on the reserve will transfer back to the Council's total Earmarked Reserves. If this happens, it materially impacts on the overall level of reserves and by 2025/26, the Council would be in a position where its total reserves were negative.

2022/23 risk assessment for determining appropriate level of balances

Area of risk	2022/23 £m	Explanation of risk/justification of balances	2021/22 £m
Emergencies	5.2	An allowance of 1.0% of annual net operating budget for the cost of responding to emergencies that falls outside of eligibility for the Bellwin Scheme	4.8
Directorate overspends	8.4	Risk that directorates will overspend due to unforeseen pressures, demography or demand (based on a 3.0% adverse variance less available Contingency budget).	9.3
Non-achievement of planned savings	4.3	Risk that savings are not achieved. Assumes 25% are not achieved	3.9
Contingent liabilities & insurance risk	4.5	Possible liabilities for which no provision has been made or funding set aside in an earmarked reserve (0.5% of gross expenditure or minimum to meet quantified contingent liabilities)	4.3
Major contracts & 3rd party spend	6.5	Risk of contractors failing, mis-specification, or non-delivery plus contract costs increase by more than allowed for in the budget - calculated as 2.0% of estimated spend on major contracts and third party spend	6.5
Total	28.9		28.8