

EAST AYRSHIRE COUNCIL

POLICY AND RESOURCES COMMITTEE – 31 MAY 2005

FINANCIAL RESERVES STRATEGY

Report by Executive Head of Finance

1 PURPOSE OF REPORT

- 1.1 To propose a strategy to determine the level and use of financial reserves.

2 BACKGROUND

- 2.1 Section 93 of the Local Government (Scotland) Act 1973 stipulates that in addition to a General Fund, Scottish councils may only hold three other reserve funds namely a Capital Fund, a Renewal and Repair Fund and an Insurance Fund. The Council has previously formally established these funds.
- 2.2 The Capital Fund can be credited with proceeds from the disposal of assets together with any other sums that the Council may determine. It can only be used for financing capital expenditure or the repayment of loans fund principal.
- 2.3 The Renewal and Repair Fund may be credited with any sums that the Council determines. It can be used to finance repairs, maintenance, replacement and renewal of fixed assets.
- 2.4 The Insurance Fund may be credited with any sums that the Council determines. It can be used to defray any loss where the Council could have insured against a loss but chose not to and for paying premiums on insurance policies.
- 2.5 In cases where an authority wants to set aside funds for a specific purpose outwith the three statutory fund areas it may choose to earmark a portion of the General Fund. Following the decision in October 2002 to allow departments to carry forward year-end balances such departmental balances have effectively been treated as earmarked reserves within the General Fund.

3 LEVEL AND UTILISATION OF RESERVES

3.1 The position of the balances of these funds at 31 March 2004 are shown below;

Fund	Balance at 31 March 2004 £m
Capital Fund	2.638
Renewal and Repair Fund	1.586
Insurance Fund	1.272
General Fund (Earmarked)	3.577
General Fund (Uncommitted)	3.689

3.2 Capital Fund

At its meeting on 24 June 2004, the Council noted that the balance of the Capital Fund was projected to be in the region of £5.5m by 31 March 2006 and having regard to the advantages resolved to commit this sum from the fund to the Building Learning Communities PPP project with the fund being replenished with the proceeds from the sale of the surplus land available once the existing school buildings have been vacated. The fund remains on track to deliver that strategy. Once the level of land receipts resulting from the PPP project are known, probably in 2007/08, members may then take a view on how to utilise these to fund additional capital expenditure in line with overall strategic priorities.

3.3 Renewal and Repair Fund

3.3.1 The Renewal and Repair Fund has previously been credited with surpluses arising on the Housing Revenue Account and 50% of trading account surpluses (before FRS17 Retirement Benefit Accounting Entries) up to a maximum of £100,000 per annum per trading service. The amounts previously credited in this way are currently ringfenced within the fund. Departments make requests of the Housing Committee or Policy and Resources Committee for drawdown of these amounts from time to time when suitable projects arise. The fact that sums held are ringfenced for specific services means that the utilisation strategy is essentially an issue for the relevant department and Service Committee.

3.4 Insurance Fund

3.4.1 The longer term strategy with regard to Insurance is for the Council to reduce the level of insurance and to retain more risk with the aim of reducing insurance premiums and the overall cost of risk. The timescale for this depends on the level of confidence in the ability of departments to exercise adequate risk control and the proposed CCTV monitoring station to be built at London Road Headquarters is expected to go some way to enhancing this. In the meantime the strategy has been to build up the insurance fund on a gradual basis so that when it is prudent to reduce insurance cover and consequently insurance costs, a buffer will be available to cope with possible peaks in losses. It is proposed that this strategy

be maintained and reviewed once further self insurance is judged to be appropriate.

3.5 General Fund Balances

- 3.5.1** It is generally accepted that the optimum level of uncommitted General Fund balance is between 2% and 4% of annual expenditure. This is required as a contingency against the impact of unexpected events and emergencies. In addition to this it may be prudent from time to time to build up funds in excess of this level to meet known or predicted liabilities. For 2005/06 net expenditure is budgeted at £278m. The optimum level of General Fund balance would therefore equate to between £5.56m and £11.12m. If a middle position were to be taken the required balance would be £8.34m. Any balance in excess of this could therefore be available for one off expenditure items or fixed life projects. This potential was highlighted by this Committee on 8 January 2005 in recommending the three year budget for 2005/06 to 2007/08 to the Council when it noted that the option to use balances should be considered during the 2006/07 budget process taking into account the financial circumstances at that time.
- 3.5.2** The introduction of the facility for departments to carry forward year-end balances has eliminated the practice of “year-end spend-up”. It has also allowed departments to take a longer term view of service planning and financial management. It is not proposed therefore to alter these arrangements. Whilst it is prudent for departments to hold such balances for unforeseen contingencies it is considered that a maximum level should be recommended. The currently projected level of balances represents around 2% of annual departmental expenditure and it is proposed that in aligning services with resources available over the three year budget period departments should take account of the level of balances and plan to hold no more than 4% of gross expenditure by the end of the three year period. Accordingly where balances significantly in excess of this are held and not identified for future anticipated liabilities or projects. Members may consider transfer of the excess to the uncommitted General Fund balance for use in other areas as determined by this committee.
- 3.5.3** It is important for departments to note that balances can not be anticipated to be replenished year on year and so must not be used to fund recurring annual expenditure. They can however be used for specific one-off issues including for example building maintenance or for fixed life projects.
- 3.5.4** Where a department has a deficit balance at the year-end, a strategy to eliminate this within the following financial year must be determined by the Executive Director with the position being monitored by the Budget Scrutiny Group. As with any other expenditure reduction measures, where any proposed action cuts across service provision or existing council policy, the appropriate Service Committee approval would be required.

4 RECOMMENDATION

- 4.1** It is recommended that members endorse the strategies for the levels of statutory reserve funds outlined in this report.

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AMcP/DMW
9 May 2005

**LIST OF BACKGROUND PAPERS
NIL**

Members wishing further information should contact Alex McPhee, Executive Head of Finance, Telephone (01563) 576300.