Reserves Strategy

Introduction

The level and use of local authority reserves continues to be a regular media topic often fuelled by comments from the Government that these reserves should be used to significantly lessen the impact of the austerity measures that have seen a greater impact on local government than any other sector.

The County Council has continually explained that reserves are kept for many different purposes and that simply trying to bridge the requirement for long term recurring savings through the use of reserves only serves to use up those reserves very quickly (meaning that they are not available for any other purposes) and merely delays the point at which the recurring savings are required.

At the end of the 2016/17 financial year the County Council's earmarked reserves together with the general fund balance stood at more than £524m an increase of approaching £27m on the previous year. This is in line with the Medium Term Financial Strategy (MTFS) as provision is built up in departmental cost of change reserves to enable support of transformation and of revenue spend whilst savings programmes are put in place, and in the Grant Equalisation Reserve (GER) ahead of a large planned draw in 2018/19. This Appendix sets out in more detail what those reserves are for and outlines the strategy that the County Council has adopted.

Reserves Position 31 March 2017

Current earmarked reserves together with the General Fund balance totalled £524.2m at the end of the 2016/17 financial year. The table below summarises by purpose the total level of reserves and balances that the County Council holds and compares this to the position reported at the end of 2015/16.

The narrative beneath the table explains in more detail the purpose for which the reserves are held and in particular why the majority of these reserves cannot be used for other reasons.

	Balance 31/03/2016 £'000	**Balance 31/03/2017 £'000**	**% of Total %**
Revenue Reserves			
General Fund Balance	20,598	21,498	4.1
Fully Committed to Existing Spend Programmes			
Revenue Grants Unapplied	35,530	17,751	3.4
General Capital Reserve	124,137	126,075	24.0
Street Lighting Reserve	9,237	26,087	5.0
Public Health Reserve	0	7,412	1.4
Other Reserves	2,091	1,977	0.4
	170,995	**179,302**	**34.2**

	Balance 31/03/2016 £'000	Balance 31/03/2017 £'000	% of Total %
Departmental / Trading Reserves			
Trading Accounts	15,671	12,753	2.4
Departmental - Cost of Change Reserve	53,926	85,658	16.4
	69,597	**98,411**	**18.8**
Risk Reserves			
Insurance Reserve	25,423	20,571	3.9
Investment Risk Reserve	1,000	1,500	0.3
	26,423	**22,071**	**4.2**
Corporate Reserves			
Grant Equalisation Reserve	75,206	40,755	7.8
Invest to Save	9,077	31,100	5.9
Corporate Efficiency Reserve	7,902	0	0.0
Corporate Policy Reserve	5,109	4,632	0.9
Organisational Change Reserve	3,593	2,905	0.5
	100,887	**79,932**	**15.1**
HCC Earmarked Reserves	**367,902**	**379,176**	**72.3**
EM3 LEP Reserve	0	1,396	0.3
Schools Reserves	55,950	46,679	8.9
Total Revenue Reserves & Balances	**444,450**	**448,749**	**85.6**
Total Capital Reserves & Balances	**52,844**	**75,415**	**14.4**
Total Reserves and Balances	**497,294**	**524,164**	**100.0**

General Fund Balance

The General Fund Balance is the only reserve that is in effect not earmarked for a specific purpose. It is set at a level recommended by the Chief Financial Officer at around 2.5% of the budget requirement and in effect it represents a working balance of resources that could be used at very short notice in the event of a major financial issue.

The current balance stands at £21.5m, which is broadly in line with the current policy.

Fully Committed to Existing Spend Programmes

By far the biggest proportion of reserves are those that are fully committed to existing spend programmes and £126m of this funding is required to meet commitments in the Capital Programme. These reserves really represent the extent to which resources, in the form of government grants or revenue contributions to capital, are received or generated in advance of the actual spend on the project.

These reserves increased significantly in recent years following a change to International Financial Reporting Standards which required unapplied government grants to be shown as earmarked reserves and due to the fact that significant revenue contributions were made to fund future capital investment using the surplus funds generated from the early achievement in savings (a deliberate strategy that is explained in more detail later in this Appendix).

These reserves do not therefore represent ‘spare’ resources in any way and will be utilised as planned in the coming years.

Specifically, the street lighting reserve represents the anticipated surplus generated by the financial model for this PFI scheme that is invested up front and then applied to the contract payments in future years. From 2016/17 elements that were previously included within the Revenue Grants Unapplied Reserve have been included to transparently identify the full amount held for this PFI scheme.

The Public Health reserve (which was previously included within the Revenue Grants Unapplied Reserve but has been separately identified from 2016/17 onwards) represents the balance of the ring-fenced government grant carried forward for future Public Health expenditure.

Departmental / Trading Reserves

Trading services within the County Council operate as semi-commercial organisations and as such they do not receive specific support from the County Council in respect of capital investment or annual pressures arising from spending or income fluctuations.

Given this position, any surpluses generated by the trading services are earmarked for their use to apply for example to equipment renewal, service expansion, service improvement, innovation and marketing. They are also used to smooth cash flows between years if deficits are made due to the loss of the customer base and provide the time and flexibility to generate new revenues to balance the bottom line in future years.

Departmental reserves are generated through under spends in annual revenue expenditure and Council policy was changed in 2010 to allow departments to retain all of their under spends in order to provide resources to:

- Meet any potential over spends in future years without the need to call on corporate resources
- Manage cash flow funding issues between years where specific projects may have been started but not fully completed within one financial year.
- Meet the cost of standard redundancy and pension payments arising from the down sizing of the work force
- Invest in new technology and other service improvements, for example the IT enabling activity associated with the Transformation to t2019 (Tt2019) Programme.
- Undertake capital repairs or improvements to assets that are not funded through the existing capital programme where this is essential to maintain service provision or maximise income generation.
- Meet the cost of significant change programmes and restructures.

By utilising reserves in this way, and allowing departments and trading areas to retain under spends or surpluses it encourages prudent financial management as managers are able to ensure that money can be re-invested in service provision without the need to look to the corporate centre to provide funding. This fosters strong financial management across the County Council and is evidenced by the strong financial position that the County Council has maintained to date.

All departments will be utilising their reserves to fund the activity to deliver the Tt2019 Programme and to cashflow the later delivery of savings if needed. The exception to this is Children's Services who will require some additional corporate support based on the current forecast of savings delivery, provision for which is made within the MTFS.

Risk Reserves

The Council holds specific reserves to mitigate risks that it faces. The County Council self insures against certain types of risks and the level of the insurance reserve is based on an independent valuation of past claims experience and the level and nature of current outstanding claims.

The Investment Risk reserve was established in 2014/15 to mitigate the slight additional risk associated with the revised approved investment strategy as a prudent response to targeting investments with higher returns.

Corporate Reserves

The above paragraphs have explained that the majority of reserves are set aside for specific purposes and are not available in general terms to support the revenue budget or for other purposes.

This leaves other available earmarked reserves that are under the control of the County Council and total nearly £79.9m at the end of last financial year. Whilst it is true to say that these reserves could be used to mitigate the loss of government grant reductions, the County Council has decided to take a more sophisticated long term approach to the use of these reserves, that brings many different benefits both directly and indirectly to the County Council and residents of Hampshire. They are broken down into four main areas:

Grant Equalisation Reserve (GER) – This reserve was set up many years ago to deal with changes in government grant that often came about due to changes in distribution methodology that had an adverse impact on Hampshire compared to other parts of the country.

In 2010/11, the County Council recognised that significant reductions in local government spending were expected and built in contributions as part of the MTFS over the CSR 2010 period from the GER in order to smooth the impact of the grant reductions.

Over the last few years, it has become clear that the period of austerity will continue at least until the end of the decade and the County Council has taken the opportunity to increase the reserve in order to be able to continue the sensible policy of smoothing the impact of grant reductions without the need to make 'knee jerk' reactions to offset large decreases in grant.

The GER currently stands at approaching £40.8m, but this reflects the fact that a significant contribution will be required in 2018/19 as part of the County Council's strategy of delivering savings over a two year cycle. Where possible, the County Council will continue to direct spare one off funding into this reserve as part of its overall longer term risk mitigation strategy, which has served it very well to date.

Invest to Save / Corporate Efficiency Reserve – These reserves are earmarked to provide funding to help transform services in order to make further revenue savings in the future. Rather than just prop up the budget on a short term basis, the County Council feels it is a far more sensible policy to use available reserves to generate savings and improve services over the longer term, by re-designing services and investing in technology and other solutions that make services more modern and efficient. These two reserves were merged at the end of 2016/17as they are used for the intrinsically the same purpose.

Corporate Policy Reserve – This small reserve is available to fund new budget initiatives that are agreed as part of the overall budget. It offers the opportunity to introduce specific service initiatives that might not have otherwise gained funding and are designed to have a high impact on service users or locations where they are applied.

Organisational Change Reserve – The County Council is one of the largest employers in Hampshire and inevitably, large reductions in government grant leading to reduced budgets means that there is a significant impact on the numbers of staff employed in the future.

The County Council, as a good employer, has attempted to manage the reduction in staff numbers as sensitively and openly as possible and introduced an enhanced voluntary redundancy scheme back in 2011. The scheme offered an enhanced redundancy rate for people who elected to take voluntary redundancy. This has been a highly successful way of managing the reductions in staff numbers, whilst maintaining morale within the rest of the workforce who are not required to go through the stress and uncertainty of facing compulsory redundancy.

In fact, since the scheme was introduced, voluntary redundancies account for around 98% of the total number of staff that have left the organisation as a result of specific restructures and service re-design.

A scheme is in place to enable the continued reduction and transformation of the workforce required to deliver the significant savings needed in the medium term with the aim of minimising compulsory redundancies

Departments are still responsible for meeting the 'standard' element of any redundancy package, but the Organisational Change Reserve was put in place to meet the 'enhanced' element of the payment. The reserve has been reviewed in the context of the new scheme and the requirement for future organisational change and this will revisited in line with the development of the Tt2019 Programme and the consequent requirement for future organisational change.

It should be highlighted that the total 'Corporate Reserves outlined above account for approximately 15% of total reserves and balances that the County Council holds and these have largely been set aside as part of a longer term strategy for dealing with the significant financial challenges that have been imposed on the County Council. In addition, the GER which comprises the majority of these 'available' Corporate Reserves, standing at £40.8m at the end of 2016/17 and due to increase in 2017/18, is in reality fully committed as the MTFS includes a planned net draw of approaching £46m required to balance the budget in 2018/19 before any changes approved as part of budget setting for 2018/19.

The reserves detailed above represent the total earmarked revenue reserves of the County Council and amount to £448.7m as shown in the table on first page of this Appendix. In addition, the County Council is required to show other reserves as part of its accounts which are outlined below.

Enterprise M3 Local Enterprise Partnership (EM3 LEP) Reserve

The County Council is the accountable body for the funding of the EM3 LEP and has therefore included the EM3 LEP's income, expenditure, assets and liabilities, (including reserves) in its accounts. Prior to 2015/16 the County Council did not include transactions relating to the EM3 LEP in its accounts.

The County Council does not control the level or use of the EM3 LEP Reserve.

Schools Reserves

Schools reserves account for nearly £47m or 8.9% of total reserves and balances. These reserves must be reported as part of the County Council's accounts, but since funds are delegated to schools any surplus is retained by them for future use by the individual school concerned. Similarly, schools are responsible for any deficits in their budgets and they maintain reserves in a similar way to the County Council in order to smooth fluctuations in cash flow over several years.

The County Council has no control at all over the level or use of school reserves.

Capital Reserves

The capital grants unapplied reserve holds capital grants that have been received in advance of the matched spending being incurred. They are not available for revenue purposes.

Reserves Strategy

The County Council's approach to reserves has been applauded in the past by the Government and the External Auditors as a sensible, prudent approach as part of a wider MTFS. This has enabled the County Council to make savings and changes in service delivery in a planned and controlled way rather than having to make urgent unplanned decisions in order to reduce expenditure.

This approach is well recognised across local government and an article in the Municipal Journal by the Director of Local Government at the Chartered Institute of Public Finance and Accountancy stated

"What reserves do allow authorities to do is to take a more medium term view of savings and expenditure and make decisions that give the best value for money. This is better than having to make unnecessary cost reductions in the short term because they do not have the money or funding cushion to allow for real transformation in the way they provide services."

We are now in an extended period of austerity which will last longer than anyone had previously predicted and the medium term view highlights a continued need for reserves to smooth the impact of reductions in funding and enable time for the planning and implementation of change to deliver savings.

The County Council's strategy for reserves was well established and operated effectively based on a cyclical pattern as follows:

- Planning ahead of time and implementing efficiencies and savings in advance of need
- Generating surplus funds in the early part of the programme
- Using these resources to fund investment and transformation in order to achieve the next phase of savings.

This cycle was clearly evident during the last four financial years, with surplus funds generated in advance of need as part of budget setting and then supplemented by further savings in the year. Savings in advance of need within departments and savings in contingency amounts due to the successful implementation of the full early savings programme meant that the Council was able to provide:

- Departmental reserves to pay for the cost of change associated with their own transformation programmes.
- Top up funding to the Organisational Change Reserve to provide resources to continue the very successful voluntary redundancy programme as a means of releasing staff in a sensitive and controlled manner that has helped maintain morale across the Council.
- Funding within the Invest to Save Reserve to help support the Tt2019 Programme and Digital 2 that will deliver the next phase of savings.
- Additional funds for the GER to help smooth the impact of grant reductions, including significant funding to bridge the unexpected budget gap in 2018/19, and give the County Council maximum flexibility in future budget setting processes.

The financial landscape has significantly shifted and looking ahead the indications are that the period to the end of the decade will be the most challenging of the prolonged austerity measures which increases the potential necessity to use reserves to alleviate the initial and ongoing financial shocks over the period to 2020

We will continue to review all reserves on an ongoing basis to ensure that there is sufficient financial capacity to cope with the challenges ahead.