Fermanagh & Omagh District Council
Comhairle Ceantair Fhear Manach agus na hÓmaí

Financial Reserves Policy

March 2023

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1. Introduction and background

The purpose of this Financial Reserve Policy is to support the Council's system of good financial governance and to assist with the effective financial management of the Council by providing adequate cover for future financial liabilities or unexpected costs. Financial Reserves are an important part of the Council's Financial Regulations as they help to maintain stability, strengthen the financial position, allow for certain expenditure to be incurred in a different period to that budgeted and can absorb some fluctuations. In the absence of Financial Reserves, the Council would have no flexibility for any variance in delivery of services or investment in capital or to meet unexpected externally driven impacts on its ability to raise income or to meet exceptional costs, all of which would impact on decision making, notably the rate setting process.

The net assets of the Council (assets less liabilities) are represented by the Reserves held by the Council. Reserves can be Usable and Unusable, however, they are generally intended for future unexpected needs or to pursue an opportunity in line with the organisation's purposes.

Reserves are an important part of the Council's financial strategy as they are necessary to secure long term budgetary stability. This is particularly important during periods of uncertainty and to ensure that there are resources available to support the priorities of the Council and to address unforeseen events that impact in-year on budgets. Usable reserves can be allocated for a specific purpose on a short-term basis but cannot be used to meet recurrent costs which require funding on an ongoing basis.

This Policy outlines the legislative and regulatory framework as well as the conditions supporting the creation, use or assessment of the adequacy of reserves to align with the Council's priorities. The policy will be reviewed in each financial year to assist with budget planning and Statutory Accounts.

This Policy has been developed in compliance with the Local Government Finance Act (Northern Ireland) 2011 and supporting Codes issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and takes account of CIPFA's LAAP bulletin 99 - Local Authority Reserves and Balances, CIPFA published guidance on building financial resilience for local authorities and the 2021 Local Government Auditor's Report.

Local Government Finance Act (NI) 2011 (the Regulations)

Section 6 of the Regulations makes provision for a Council to maintain financial reserves in accordance with the Regulations, that the Chief Financial Officer of a Council shall submit to the Council a report on the adequacy of any proposed financial reserves for a financial year and that a Council shall have regard to that report when considering the estimates for that year under section 3(2)(a) of the Regulations.

Regulation 9 enables Councils to maintain other fund reserves in addition to the General Fund as it considers appropriate.

Section 10 of the Regulations states that a Council shall not directly or indirectly apply any money under its control for any purpose not authorised specifically or generally by a statutory provision.

Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011 – these Regulations cover annual budgets, accounting for capital expenditure, borrowing, credit arrangements, capital expenditure and capital receipts.

The Regulations, associated guidance, which may be issued by the Department for Communities, and CIPFA Codes of Practice must be followed by a Council, in particular with respect to the charging of expenditure to the General Fund.

CIPFA Codes of Practice

The Financial Management Code (FM Code) – this provides guidance for good and sustainable financial management in local authorities. By complying with the principles and standards within the code authorities will be able to demonstrate their financial sustainability.

The Prudential Code for Capital Finance 2021 – any framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within this clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable.

CIPFA **LAAP bulletin 99 - Local Authority Reserves and Balances** – provides guidance to help local authorities develop a framework for reserves including the establishment and maintenance of reserves and balances and the purpose and key issues to consider when determining the appropriate level of reserves. This is supported by CIPFA **guidance on building financial resilience** which considers planning for the long-term with the necessity to ensure organisational resilience to deliver annual savings and manage significant financial shocks while still pursuing ambitious goals for local communities. The guidance focuses on getting routine financial management right, benchmarking, having clear plans for delivering savings and managing reserves.

The **2021 Local Government Auditor's Report** notes that Usable Reserves play an important role in councils' financial management and the main usable reserve types include General Fund, Capital Reserves and Renewal and Repairs Fund which can be used to respond to unexpected events, or supplement income where necessary, and to finance major projects. The Auditors report highlighted that Council's should have a defined program for managing reserves and have clear plans in place for usable reserves, including those set up to manage the impact of Covid-19 noting that usable reserves should be managed carefully and are an important resource as councils recover from the financial impact of Covid-19, and advised that Councils should have clear plans setting out how these reserves will be used and that robust financial planning and management processes will be essential to ensure councils continued financial sustainability.

2. Role of the Chief Financial Officer

Regulation 6 of the Finance Act (NI) 2011 makes provision requiring a council to maintain financial reserves in accordance with the regulations, that the Chief Financial Officer (CFO) of a council shall submit to the council a report on the adequacy of any proposed financial reserves for a financial year and that a council shall have regard to that report when considering the estimates for that year under section 3(2)(a). The Chief Executive of Fermanagh and Omagh District Council is the designated Chief Financial Officer.

Regulation 7 refers to Controlled Reserves which are by definition a financial reserve of a description prescribed under Section 6. The Regulation requires the balance of the Controlled Reserve, which for the purposes of the Council is its General Fund, at the end of any financial year to be at no less than the minimum amount determined in accordance with Regulations. If in any financial year it appears to the Chief Financial Officer of a council that a controlled reserve is or is likely to be inadequate, the chief financial officer shall report to the council on—

(a) the reasons for that situation; and

(b) the action, if any, which the Chief Financial Officer considers it would be appropriate to take to prevent such a situation arising in relation to the corresponding reserve for the next financial year.

The Regulation determines that a controlled reserve is inadequate if the balance of the reserve at the end of a financial year is less than the minimum amount determined in accordance with regulations under section 6(1) and that a Council shall have regard to any report under this section when considering the estimates for the next financial year.

Within the existing statutory and regulatory framework, it is the responsibility of CFO to determine estimates and to advise the Council on the Minimum General Reserve balance that the Council needs to hold. In assessing the adequacy of general reserves, the CFO will take account of the strategic, operational and financial risks facing the authority. The Chief Financial Officer must be satisfied that the decisions taken on balances and reserves represent proper stewardship of public funds. This means that the CFO will partake in the review and management processes to reach well informed decisions.

The level and utilisation of reserves is determined formally by the Council of which there is no statutory minimum. The Council makes its own judgement taking account of all the relevant circumstances, professional judgment and advice of the CFO. To enable the Council to reach a decision, the CFO reports the various factors and an assessment of the financial risks that have influenced the CFO judgement including ensuring that the expenditure incurred will not have a detrimental effect to the Council’s overall finances. The CFO is required to make sure that the advice given is formally recorded and this is undertaken during the Annual Estimates and Rates Setting Process reporting to a Special Council Meeting in February of each year (before the prescribed Rates setting date of 15 February) and to the Council’s Policy and Resources Committee as and when required.

A summary of safeguards in place that will help to prevent the Council over-committing themselves financially includes:-

- Chief Financial Officer’s duty to report on the robustness of estimates and adequacy of reserves (section 4 and 6 of the Local Government Finance Act (NI) 2011)
- The legislative requirement to make arrangements for the proper administration of financial affairs and the responsibility for those affaires (section 1 of the Local Government Finance Act (NI) 2011
- Requirements of CIPFA Prudential Codes to have full regard to affordability when making recommendations about the Council’s future capital programme including consideration of level of resources available to it.

3. Sources and Types of Reserves

Reserves are reported in two categories called Unusable and Usable Reserves. The unusable reserves cannot be used to fund expenditure and are used to hold technical accounting balances in order to comply with the accounting requirements of the CIPFA Accounting Code of Practice, while the usable reserves can be applied to fund general expenditure although some can only be used to fund capital expenditure.

3.1 Unusable Reserves

Unusable reserves arise out of the interaction of legislation and proper accounting practice either to accumulate revaluations gains or as adjustment accounts to reconcile accounting requirements driven by reporting standards to statutory requirements. These Reserves, which are not resource backed, cannot be used by the Council to provide services as they represent unrealised gains and losses. Unusable reserves (for example the Revaluation Reserve) would only become available for use if assets are sold. Unusable Reserves may also relate to timing differences. Examples of Unusable Reserves, which are disclosed in the Council’s Annual Statement of Accounts, are as follows:-

- Capital Adjustment Account
- Revaluation Reserve
- Pension Reserve
- Capital Receipts Deferred Account
- Accumulated Absences Account
- Provisions Discount Rate Reserve

Other such reserves may be created in future where developments in the Council's accounting result in timing differences between the recognition of income and expenditure under proper accounting practice and under statute or regulation.

3.2 Usable Reserves

Usable Reserves are reserves that the Council may hold and use to support expenditure and, in some instances, provide services. The level and use of Reserves is subject to the need to maintain a prudent level of reserves and any statutory limitations on their use (for example the Capital Receipts Reserve that may only be used to fund capital expenditure or repay debt).

Usable Reserves can be sub-divided into the following categories:-

- **General Fund Reserves** – a contingency to mitigate the impact of uneven cash flows, unexpected events or emergency situations, and avoiding unnecessary temporary borrowing.
- **Earmarked Reserves** – established and built up over a period of time to meet known or predicted liabilities. These are still part of the General Fund but are accounted for separately.

  Other Reserves – are Capital Reserves which are built through the disposal of assets generating Capital Receipts, Capital Grants Unapplied Account relating to grant aid received but not yet expended and the Capital Fund and Renewals and Repairs Funds both set up under statue.

3.2.1 General Fund Reserves

The Council's General Fund Reserve represents the build-up of balances through additional income generated or revenue underspend over a number of years. The Council's policy is that the balance has to be of a sufficient level to provide financial stability with a contingency to enable unforeseen fluctuations in future spending to be met and growth to be contained. It is also part of Council policy to be able to provide resilience in response to strategic, operational, and financial risks and issues as they arise.

The Council's Estimates and Rates setting process requires service managers to carefully review their services in order to deliver a balanced budget requirement that supports corporate objectives and priorities without the necessity to support ongoing revenue expenditure through contributions from the balance on the General Fund Reserve. Any proposed use of the balance should, as far as possible, only be on time-limited initiatives and not those of a recurrent nature that could not be sustained over the medium and long terms. All proposed transfers to and from the Reserve will be presented to the Council's Policy and Resources Committee for approval.

There is an opportunity cost of holding the General Fund Reserve as the accrued funds could be spent on one-off investments in services, notwithstanding the fact that the funds are required to meet risks and uncertainties.

An annual review of the balance on the General Fund Reserve will be undertaken by the Council who will take the professional advice of the Chief Financial Officer, who is required, under statue, to set a minimum general reserve balance each year as part of the Estimates and Rates Setting process to ensure the financial stability of the Council.

The General Fund Reserve can be deemed inappropriate if the balance by the end of the financial year is less than the minimum amount determined in accordance with regulations set out in Section 7 of the Local Government Finance Act 2011. If this is the case then the CFO shall report to the council:

- The reasons for that situation; and
- Any action which the CFO considers appropriate to prevent such a situation from arising in relation to the corresponding reserve for the next financial year.

3.2.2 Earmarked Reserves

The Council holds Earmarked Reserves for specific purposes, which are identified in the Annual Statement of Accounts as 'Other Balances and Reserves' and mainly include:-

- Sums set aside for schemes - known responsibilities or liabilities ; and
- Budget strategy - where specific liabilities remain but they are not formal commitments in accounting terms these are earmarked and used to offset liabilities.
- Other earmarked reserves will be set up from time to time to meet predicted liabilities, for example future predicted demand or external pressures and risks arising from market price fluctuations, to support financial resilience and to reflect potential risks arising from a reduction in Business Rates. Earmarked reserves include the Council's

Covid contingency and resilience reserve and an Election Reserve.

The Council will review these Earmarked reserves at least twice annually as part of the Estimates and Rates setting process and as part of the Annual Statement of Accounts to ensure the balances are challenged and justifiable to ensure continuing relevance and adequacy.

3.2.3 Other Reserves

- **Capital Receipts Reserve** – Regulation 20 of the Local Government Finance Act (NI) 2011 defines a capital receipt as 'a sum received by the council in respect of the disposal by it of an interest in a capital asset' and in compliance with Regulation 22 the Council will only use capital receipts to meet (a) capital expenditure or (b) debt and other liabilities. In line with the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011 receipts from the disposal of fixed assets amounting to £5,000 or more will be credited to this Reserve.
- **Capital Grants Unapplied Account -** This is effectively capital grants received from external bodies mainly central government which is held in a Reserve and not used until the associated expenditure is incurred at which stage the capital grant is used to fund the expenditure in line with associated letters of offer and funding commitments entered into by the Council and the external funder. Accounting Standards require grants, which have all conditions pertaining to it met at the end of each financial year to be recognised in the Annual Statement of Accounts.
- **Capital Fund -** This fund was established under section 56 of the Local Government Act (NI) 1972, as repealed and restated under the Local Government Finance Act (Northern Ireland) 2011 and is set aside for the specific purpose of capital expenditure.
- **Renewals and Repairs Funds** – This fund was established under section 56 of the Local Government Act (NI) 1972, as repealed and restated under the Local Government Finance Act (Northern Ireland) 2011 and set aside for the specific purpose of repairing existing assets or capital expenditure.

4. Adequacy of Reserves

4.1 Principles Used to Assess the Adequacy of Reserves

In assessing the adequacy of reserves the Chief Financial Officer must take account of the strategic, operational and financial risks facing the Council over the medium term and the Council's overall approach to risk management in order to properly assess the adequacy of unallocated general reserves held in the General Fund reserve. Key factors regarding budget assumptions are shown below:

Budget Assumptions	Financial standing and management
The outlook for inflation and interest rates.	The overall financial standing of the authority (level of borrowing, debt outstanding, council tax collection rates and so on). Rises in the prices of some commodities, such as fuel, highlight the relevance of using a number of inflation rates in the budget and financial strategy, and considering whether reserves are adequate to deal with unexpected increases.
The potential range of costs of demand-led services.	The Council's capacity to manage in-year budget pressures, and its strategy for managing both demand and service delivery in the longer term.
The general financial climate the Council is subject to and the availability of reserves, government grants and other funds to deal with significant contingencies and the adequacy of provisions.	External factors such as future external support and funding, affordability of District Rates by the ratepayer and customer demand for services will influence the Council's ability to replenish reserves once they have been used. The Council's appetite to hold contingent sums to take account of significant potential fluctuations in external funding, central government support and potential losses in the Rates base. Any plans for using reserves will consider the Council's appetite to financial risk to ensure financial stability and will consider the need and ability of the Council to replenish the reserves, and further risks the Council may be exposed to whilst replenishing the reserves.
The financial risks inherent in any significant new projects or major capital developments.	The Council's virement and end of year procedures in relation to budget under/overspends.

4.2 Periodical Reviews of Reserves

The Council recognises the opportunity cost of holding balances as reserves and the risks of potentially holding more than necessary as reserves are earmarked for spending that is uncertain in timing or cost. For this reason, the levels and use of reserves will be monitored during each financial year as part of the reporting on financial matters including the actual financial position against budget for both revenue and capital, as well as reviewing annually during the Estimates and Rates Setting process and as part of the

Annual Statement of Accounts process by the Chief Financial Officer with associated recommendations presented to Council or the Policy and Resources Committee which will consider the following procedures:-

- The rationale for keeping each reserve with reference to the Council's future spending plans, ensuring that resources are focused effectively on priorities.
- The required funds including an expected minimum and maximum for risk-based reserves.
- The length of time that the reserves have been held for and projections for using them which will be monitored.
- Creation of new earmarked reserves at the end of the financial year if the use of the reserve has been met or as an addition to an existing reserve.

The bases and reasoning for recommending a certain level for each reserve will be reported to the Council committee as part of the budget setting process and/or part of the Accounts Statement of Accounts reporting stage.

4.3 Use of Reserves

The **General Fund Reserves** can be used to meet unexpected events but can also be used to supplement un-budgeted though necessary expenditure that can impact service delivery.

Earmarked reserves are liable to have their uses changed by the Council Committee on advice from the CFO, allowing them to move funds between reserves and also reduce or eliminate funds in earmarked reserves by reallocating them to the General Fund reserves. These reserves can be used to meet known future predicted liabilities subject to formal future commitment and to support financial resilience due to external influencing factors.

Other Reserves are specific to capital expenditure, can only be used once and will not be used to finance recurring planned revenue spending.

Reserve balances will be managed and invested in line with the Council's Treasury Management Policy and Strategy Statement which is reviewed by the Council on an annual basis.

5. Reporting Framework

The level and utilisation of reserves will be determined formally by the Council, informed by the advice and judgement of the CFO. The CFO will report the factors that influenced the CFO judgement and ensure that the advice given is recorded formally to enable the Council to reach its decision. The day-to-day management of Reserve balances will be the responsibility of the Head of Finance.

Reports will be presented to Council as part of the Annual Estimates and Rates Setting process, as part of the Annual Statement of Accounts and periodically throughout the financial year to the Council's Policy and Resources Committee, in line with the Council's Financial Regulations, which will include at regular intervals, recommendations on transfers to and from Reserves. The Movement in Reserves Statement is one of the primary statements included in the Annual Statement of Accounts which presents the movement in the year of the Reserves of the Council analysed into Usable and Unusable Reserves.

Separately a report on the proposed use of a Reserve should an unexpected financial situation occur will be presented to the next Council or Policy and Resources Committee for consideration.

Part of the risk management process will involve taking appropriate action to mitigate or remove risks, where this is possible. This may lead to a lower level of reserves being required and would be appropriate to consider reducing the level of balances held where appropriate action to mitigate or remove risks has been successfully undertaken. The Council will strive to achieve a balance between maintaining adequate levels of Reserves and investing in risk reduction measures which will be considered as part of the Annual Estimates and budget setting process. When considering the level of reserves, the Council will consider any likely level of central government support.

This policy will be reviewed annually, or sooner if warranted, by external or internal events or changes. Proposed changes to the policy will be presented to the Policy and Resources Committee.