

FINANCIAL RESERVES POLICY (Updated by Council 25th November 2020)

1) Introduction

- a) Kennington Community Council is required to maintain adequate financial reserves to meet the needs of the organisation. The purpose of this policy is to set out how the Council will determine and review the level of reserves.
- b) Sections 32 and 43 of the Local Government Finance Act 1992 require local authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement. There is no specified minimum level of reserves that an authority should hold and it is the responsibility of the Responsible Financial Officer to advise the Council about the level of reserves and to ensure that there are procedures for their establishment and use.
- c) This document sets out the Council's reserves policy. The principles which underpin the policy are set out in the Annex.

2) Types of Reserve

- a) When creating a reserve, the Council will define it as one of three types:
 - i) General;
 - ii) Earmarked (held for a specific purpose); or
 - iii) Ring-fenced (held for one purpose only and cannot be transferred).

3) Rules governing reserves

- a) The General Reserve will be established to provide the Council with a working balance to avoid unnecessary temporary borrowing and to help to cope with unexpected expenditure and unexpected interruptions to income or cash flow. The Council will aim to build and maintain the reserve to between 50 per cent and 60 per cent of the annual precept and maintain it in that range. Annual budgets will take this into account. The Council will do this by:
 - i) in 2019/20, setting aside 12.5 per cent of its income and unspent sums at the year-end which were not allocated to an earmarked or ring-fenced reserve, which combined amounted to £50,000;

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- ii) in 2020/2021 and subsequent years, setting aside 10 per cent of any increase in its annual precept and unspent sums at the year-end which have not been allocated to an earmarked or ring-fenced reserve until such times as the Reserve is within the target range.

If the General Reserve becomes depleted below the target range, the fund will be built up in subsequent years (primarily through an allocation from the annual budget) to the agreed minimum balance. In a year in which the annual precept is reduced, Council will consider whether there should be any consequent adjustment to the General Reserve.

- b) An Earmarked Reserve may be established by a simple majority of Council, including as part of the act of approving the budget or the accounts, and will be designed to meet known or predicted requirements, including projects; earmarked reserves may also be established for statutory reasons. The setting aside of funds over a period of time to meet known future expenditure permits the Council to spread costs over several years. The Council, when establishing an earmarked reserve, will set out the purpose of the reserve and how and when it can be used. The Financial and General Purposes Committee will review all Earmarked Reserves annually on the advice of the Responsible Officer and recommend to Council any necessary action, which will require a simple majority in Council to be approved.
- c) A Ring-fenced Reserve will be established where a grant has been received from a third party for a specific project at the time when it is received. The Council, when establishing a ring-fenced reserve, will set out the purpose of the reserve and how and when it can be used. Any proposal to spend a Ring-fenced Reserve for something other than its designated purpose will require a motion in Council approved by at least 60 per cent of Councillors present and voting; such a proposal may only be tabled after confirmation from the Responsible Officer that he/she has consulted the third party from which the grant originated and been assured in writing that the proposal is within the rules of that organisation. It may be returned to the originator at their request if conditions for spending it cannot be met and the expenditure has not already been committed.

4) Reserves and contingencies

Council may make provision in budgets for specific contingencies. In such cases, it will not hold reserves to meet those contingencies.

Conversely, if Council ear-marks a reserve to meet a contingency, it will not also allocate a contingency in the budget.

**PRINCIPLES UNDERPINNING THE KENNINGTON COMMUNITY COUNCIL
RESERVES POLICY**

1) General Principles

- a) The Department of Communities and Local Government, in their guidance “The Good Councillor’s guide to finance and transparency” (2017) states that:
- i) Local councils need to hold an amount in reserves to meet unexpected expenditure, otherwise they could run out of money before the end of the financial year. A council should typically hold between 3 and 12 months expenditure as a general reserve. If the general reserve is too low then it may not be enough to cover unexpected expenditure or emergencies, whilst if the general reserve is too high then local electors have paid a tax which is not being used for the benefit of the local community.
 - ii) Local councils have no legal powers to hold revenue reserves other than for reasonable working capital or for specifically earmarked purposes, therefore the year-end general reserve should not be significantly higher than the annual precept.
 - iii) The council may have ‘earmarked reserves’ for specific projects, where money is allocated for a specific purpose but may not be spent in that financial year. This may include reserves to purchase or renovate a building, develop a sports facility or community centre.
 - iv) Many councils also hold an ‘election reserve’, as all reasonable costs of holding local council elections can be fully recharged by the district or unitary council to the local council. In the case of contested elections for a council with several wards then these costs can be relatively high.
 - v) If the amount of reserves at the year-end are above a certain level in relation to the annual precept then the council must advise the external auditor of why this level of reserves is required.
- b) Kennington Community Council will adopt this guidance when considering financial reserves.

2) Types of Reserves

Reserves can be categorised as General or Earmarked/Ring-Fenced.

- a) General Reserves are funds which do not have any restrictions as to their use. These reserves can be used to smooth the impact of uneven cash flows, offset the budget requirement if necessary or can be held in case of unexpected events or emergencies.
- b) Earmarked/Ring-Fenced reserves can be established to meet known or predicted liabilities. Reasons may include:
 - i) Grants from other organisations for specific projects. These will often have specific conditions regarding use and timescale, and may be subject to surrender if they are not spent. Such grants may need to be subject to particularly strict rules and ring-fenced.
 - ii) Election reserves, to meet the potential costs of local elections to the Council.
 - iii) Renewals – to enable services to plan and finance an effective programme of vehicle, equipment and infrastructure replacement and planned property maintenance. These reserves are a mechanism to smooth expenditure so that a sensible replacement programme can be achieved without the need to vary budgets.
 - iv) Insurance reserve – to enable the Council to meet the excesses of claims not covered by insurance.

3) General Reserves

- a) The level of the General Reserves is a matter of judgement and judgements may change over time in the light of external circumstance and experience. The primary means of building a general reserve will be through an allocation from the annual budget. This will take into account any amounts needed to replenish reserves that have been consumed in the previous year.
- b) Setting the level of the General Reserve is one of several related decisions in the formulation of the medium term financial strategy and the annual budget. The Council must build and maintain sufficient

working balances to cover the key risks it faces, as expressed in its financial risk assessment.

- c) Reserves should not be utilised to fund on-going expenditure. This would be unsustainable as, at some point, the reserves would be exhausted. To the extent that reserves are used to meet short term funding gaps, they must be replenished in the following year. If in extreme circumstances the General Reserve was exhausted due to major unforeseen spending pressures within a particular financial year, the Council might decide to draw down from its earmarked reserves to provide short term resources.
- d) Even at times when extreme pressure is put on the Council's finances, the Council must keep a minimum balance sufficient to pay three months' salaries to staff in the General Reserve at all times.

4) Earmarked Reserves

- a) Earmarked reserves will be established on an "as required" basis, in line with anticipated requirements.
- b) Any decision to set up a reserve must be made by the Council, taking into account the recommendations of the Finance and General Purposes Committee and the Responsible Financial Officer.
- c) Expenditure from reserves can only be authorised by the Council.
- d) Earmarked reserves that have been used to meet a specific liability do not need to be replenished, having served the purpose for which they were originally established.
- e) All Earmarked Reserves are recorded on a central schedule held by the Responsible Financial Officer which lists the date established, the source of funds if from an external organisation, and the purpose for which they are held.
- f) Reviewing the Council's Financial Risk Assessment is part of the budgeting and year end accounting procedures and identifies planned and unplanned expenditure items and thereby indicates an appropriate level of Reserves.

5) Investment of funds held as reserves

- a) When considering opportunities to invest funds held as reserves the Council will at all times take account of relevant legislation and Government guidance including the Ministry of Housing, Communities & Local Government “Capital finance: guidance on local government investments” (edition applicable from 1 April 2018).

6) Opportunity cost of holding reserves

- a) In addition to allowing the Council to manage unforeseen financial pressures and plan for known or predicted liabilities, there can be a benefit to holding reserves in terms of the interest earned on funds which are not utilised. This investment income is fed into the budget strategy.
- b) However, there is an “opportunity cost” of holding funds in reserves, in that these funds cannot then be spent on anything else. Given the opportunity costs of holding reserves, it is critical that reserves continue to be reviewed each year as part of the budget process.

Revision History

Version	Date	Comments
0.2		Created Chris Morley
0.3	10.08.2019	Created Alan Cooper. Entirely new body text; previous version taken into Annex with some amendments
0.3 corr	11.08.2019	Created Alan Cooper. Footer numbering corrected and version control table added
0.4	13.08.2019	Created Alan Cooper. Editorial amendments to sub paras i), ii) and iii) of para 3 a) on suggestion of Chris Morley
1.0	9.10.2019	Approved by Council

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1.1	1.10.2020	Created Alan Cooper. Updated to reflect actual 2019-20 contribution to reserves. Annex re-edited. Submitted to FGP
1.2	5.11.2020	Addition to 3 a) requested by FGP
2.0	[11.11.2020]	[Approved by Council]