

<b>SUBJECT</b>	<b>2018-19 RESERVE USAGE FORECAST</b>
<b>DIRECTORATE</b>	<b>Chief Executive's Unit</b>
<b>MEETING</b>	<b>Audit Committee</b>
<b>DATE</b>	<b>12th September 2018</b>
<b>DIVISIONS/WARD AFFECTED</b>	<b>All Authority</b>

## **1 PURPOSE**

- 1.1 To appraise audit members of the prospective reserve usage in conjunction with continuing to highlight the revised reserves protocol endorsed by Cabinet.
- 1.2 A periodic focus by Audit Committee on reserve usage is important due to
- Future funding gap and continuing low settlements
  - Pressures arising from such issues as increasing demand, new and changing legislation, changes in the wider economy and hard to predict events.
  - Grant funding streams being reduced or stopped at short notice
  - Capital receipts and other income streams not being achieved
  - Saving proposals not being delivered and increased demand on services leading to overspends

## **2 REVISED RESERVES PROTOCOL**

- 2.1 The detailed report received by Cabinet in July 15 was prompted by;
- Faster than expected use of earmarked reserves over the last 4 year period
  - Limited opportunities to replenish reserves from in year underspends as budgets get tighter
  - Limited opportunities to redistribute reserves as various reserves are used up
  - Risks around the on-going austerity measures, the projected gap in the MTFP and the lack of clarity on the Authority's future business model or longer term financial plan to respond to this, notwithstanding the work recently commenced around 'Future Monmouthshire'.
  - Huge commitment of capital resources to Future Schools
  - The need for reserves to work harder
  - The need to consider some issues as requiring base budgets rather than continued funding from reserves e.g. redundancy costs are unfortunately going to be an ongoing feature of expense for the Authority every year.

### 3 RESERVE ACTIVITY

3.1 The Council has unallocated reserves in the form of Council fund balance and school reserves. Realistically the level of surplus/deficit affecting Council Fund will commonly fluctuate before the end of the year, but for estimating purposes we will commonly presume services' activities influenced to avoid material adverse effect.

Revenue and Capital monitoring reflects an approved use of earmarked reserves. At month 2, service managers' presumptions are to fully utilise the reserve funding conveyed to them in 2018-19 budget. So at the end of 2018-19 (based on period 1 activity), the predicted reserve position for both general fund reserve and earmarked reserves is anticipated to amount to,

#### Reserve Usage

	01/04/2018	Contribution to Reserves	Contribution from Reserves - revenue	Contribution from Reserves - capital	31/03/2019
<b>Sub Total Council Fund</b>	<b>-7,286,303</b>	0	0	0	<b>-7,286,303</b>
<i>Earmarked Reserves:</i>					
<b>Sub-Total Invest to Redesign</b>	<b>-1,302,343</b>	<b>-170,681</b>	401,714	0	<b>-1,071,310</b>
<b>Sub-Total IT Transformation</b>	<b>-734,881</b>	0	215,913	0	<b>-518,969</b>
<b>Sub-Total Insurance and Risk Management</b>	<b>-1,046,416</b>	0	0	0	<b>-1,046,416</b>
<b>Sub-Total Capital Receipt Generation</b>	<b>-347,139</b>	0	153,415	0	<b>-193,724</b>
<b>Sub Total Treasury Equalisation</b>	<b>-990,024</b>	0	0	0	<b>-990,024</b>
<b>Sub-Total Redundancy and Pensions</b>	<b>-496,813</b>	0	163,978	0	<b>-332,835</b>
<b>Sub-Total Capital Investment</b>	<b>-648,336</b>	0	0	17,999	<b>-630,337</b>
<b>Sub-Total Priority Investment</b>	<b>-686,751</b>	0	386,751	0	<b>-300,000</b>
<i>Other Earmarked Reserves:</i>					
Museums Acquisitions Reserve	-55,885	0	0	0	-55,885
Elections Reserve	-58,183	-25,000	0	0	-83,183
Grass Routes Buses Reserve	-146,084	-5,000	0	0	-151,084
Youth Offending Team	-248,989	0	98,989	0	-150,000
Building Control trading reserve	-22,254	0	0	0	-22,254
Outdoor Education Centres Trading Reserve	-129,500	0	40,000	0	-89,500
CYP maternity	-142	0	0	0	-142
Plant & Equipment reserve (Highways)	-150,000	0	0	0	-150,000
Homeless Prevention Reserve Fund	-9,536	0	0	0	-9,536
Solar Farm Maintenance & Community Fund	-23,000	-23,000	0	0	-46,000
Rural Development Plan Reserve	-277,665	0	86,471	0	-191,194
<b>Total Earmarked Reserves</b>	<b>-7,373,942</b>	<b>-223,681</b>	1,547,231	17,999	<b>-6,032,393</b>
<b>Total useable revenue reserves</b>	<b>-14,660,245</b>	<b>-223,681</b>	1,547,231	17,999	<b>-13,318,696</b>

3.2 As a useful reminder, with regard to the allocation of bottom line surplus to replenish reserves, the Sc151 officer's considered advice at outturn was

Priority Investment Fund (to extinguish Leisure Trust facilitation costs)	£155k
Capital Receipts Generation Reserve (Capital receipts generation reserve part funds Valuation team's cost, and a top up is necessary to accord with their indicative 2018-19 costs.)	£70k
Balance Invest to Redesign Reserve	£448k
<b>Total</b>	<b>£653k</b>

3.3 Despite those top ups, the current predicted use of the Priority investment reserve means that it will likely expire by the end of 2018-19 as a funding source, as the £300k yearend balance is earmarked/allocated to local development plan purposes. Given the forecast use of earmarked reserves, Cabinet has previously approved a policy on earmarked reserves to ensure that these one off resources are focused on investment in areas where they can achieve most impact hence putting the balance for redistribution into "Invest to Re-design".

### **Schools Reserves**

3.4 The Schools reserve category has received a number of significant changes since last periodic reserve report, which would be helpful to update Audit Committee members with.

3.5 By way of background, each of the Authority's Schools is directly governed by a Board of Governors, which is responsible for managing their school's finances. However, the Authority also holds a key responsibility for monitoring the overall financial performance of schools.

3.6 The net effect of an individual school's annual surplus or deficit is shown in a ring-fence reserve for the particular school. Details of which for each school are included in Appendix 2, together with an indication of any recovery plan targets agreed and how close the Governing Body is in satisfying that responsibility in current year.

3.7 In summary form the anticipated outturn school balances are predicted to be,

	<b>Opening Reserves 2018-19 (surplus)/deficit</b>	<b>In year position at Month 2 (surplus)/deficit</b>	<b>Anticipated Outturn Position (surplus)/deficit</b>
<b>Combined balance</b>	<b>(£175,225)</b>	<b>£797,703</b>	<b>£622,478</b>

3.8 Whilst any extraordinary funding from WG and beneficial revisions to budgeted draw on reserves will sustain the reserve situation for longer than is often predicted, it remains unlikely that the collective level of reserves will sustain the traditional annual draw by schools on reserves in recent years, which will add additional focus by schools to address the need to remain within budget going forward rather than passporting the consequences to their reserves, given that collective flexibility is now pretty much exhausted.

- 3.9 The following table exhibits the net trend in use, indicating collectively schools are using reserves at a considerably faster rate recently than they are replenishing.

Financial Year-end	Net level of School Balances
2011-12	(965)
2012-13	(1,240)
2013-14	(988)
2014-15	(1,140)
2015-16	(1,156)
2016-17	(269)
2017-18	(175)
2018-19 forecast	£622

Our Fairer Funding Regulations adopted by Council and Governing Bodies have traditionally precluded governing bodies from planning for a deficit position. This was changed in 2016-17, (which coincides quite closely with declining net balance above) to allow licensed deficits where a recovery plan is agreed and followed. However this flexibility only extended as far as there being a collective schools reserve surplus.

- 3.10 There are however weaknesses in the forecasting approaches of individual schools, such that the budgeted outturn use of reserves seldom matches the reality.

As an example, during last year's monitoring ,schools reported predicted use of reserves initially was £823k, and necessitated at month 2, the Director of CYP prepare a report outlining to Cabinet his strategy for address.

Subsequently whilst an extraordinary Welsh Government grant of £344k in the last quarter of 2017-18 would have had a beneficial effect on balance levels, collectively they only actually used £94k of their reserves for the year, a £900k variation in original forecasting. That sort of volatility potentially makes it very difficult for senior colleagues and Members to predict the necessary action from year to year.

But based on those school predictions, general trends can be extrapolated, so 12 schools started this year in deficit. There is an increasing trend of schools entering deficit, (net further 6 predicted at present by schools), and that position looks particularly acute in 3 out of the 4 secondary schools, and that 4th comprehensive school has had a very close monitoring regime applied to it during its recovery period, building upon the ownership and responsibility of the Governing body supported by headteacher, bursar and management team to end last year with £180k surplus. It is highly questionable whether that level of engagement and interaction would be possible/likely in respect of 18+ scenarios. CYP colleagues will be prioritising the most significant aspects, but

it can be seen from the recovery plan indicators included alongside the reserve position in Appendix 2, that some of the schools starting the year in deficit still had no agreed recovery plan, whilst others showed a perverse agreement to an increasing deficit.

- 3.11 Cabinet reflected upon these observations at their meeting of 25<sup>th</sup> July 2018, and have endorsed revisions in practice and the fairer funding guidelines now read (the emphasis of the change helpfully being underlined),

#### **4.1 Carry Forward of Balances**

*“4.1.1 Schools will be able to carry forward from one financial year to the next any shortfall in expenditure relative to the school’s budget share for the year, plus or minus any balance brought forward from the previous year. Where the periodic monitoring exercise predicts this shortfall would move the school into a net deficit position, the Governing body is required to meet and provide a Recovery Plan consistent with “Planning for Deficit Balances” in para 4.3.1 below, within 6 weeks of the deficit anticipation becoming known.”*

#### **Planning for Deficit Balances**

*“4.3.1 This scheme allows governing bodies to plan for a budget deficit, only where a recovery plan has been prepared and submitted alongside and at the same time as the deficit budget is presented. A Recovery Plan being defined as a Governing Body prepared multi year budget, to be considered and agreed with Cabinet Member Children and Young People, indicating the quantified financial improvement actions to remove the deficit within 3 years, or longer by specific agreement with Cabinet Member Resources.”*

#### **4.4 Obligation to carry forward Deficit Balances**

*“4.4.1 Where a school has a deficit balance at the end of the year, such deficit will be carried forward into the next financial year. The recovery plan will be monitored on a termly basis at minimum, but in material cases this will be monitored monthly. Governing body representatives may be required to report periodically to the Council on the progress of recovery actions. The authority has the right to withdrawn the delegated budget and powers of the governing body should the plan not be followed.*

“4.7.1 The authority will only support licensed deficits where a recovery plan is in place, as detailed in paragraph 4.3.1. The governing body must request a licenced deficit from the Cabinet Member Children and Young People.

- 3.12 These changes are anticipated to have a twofold benefit in allowing the potential for deficits to be considered in a more timely fashion than at present, and better recognises the accountability for schools financial arrangements rests with Governing Bodies rather their headteachers, who have their financial responsibility delegated to them by Governing Body.
- 3.13 It also helpfully recognises that the problem is not so much with schools actual use of reserves but more to do with their forecast or budgeted draw. The bringing forward of Recovery Plan submissions, to be consistent with annual budget consideration, is designed to provide a better quality of data/information on which to consider the approval of any deficit budget, and would be reassuring to Members that any annual deficit volatility is accommodated within a multi-year budget strategy.

#### **4 REASONS**

- 4.1 To comply with best practice regarding the management and review of earmarked reserves and the Financial Procedure Rules within the Authority's constitution.

#### **5 RESOURCE IMPLICATIONS**

- 5.1 As a financial planning assumption, the level of Council Fund reserves should be between 4% - 6% of net expenditure. Based on a budgeted net expenditure (excluding Police and Community Council precepts) and before financing totalling £144.2 million, the anticipated outturn Council fund reserve level equates to 5.06%, which is towards the middle of agreed acceptable levels. This reduces to 4.5%, if net year end schools balances position remains as initially predicted in para 3.7.
- 5.2 There is an immaterial level of earmarked reserve replenishment built into the annual budget, and by necessity Head of Finance considers the replenishment of specific reserves where year-end surpluses allow.
- 5.4 Earmarked reserves remain at limited levels unlikely to provide any material capacity/headroom to meet unanticipated volatility or significantly facilitate future service re-engineering and design consequential with setting an annual budget that involves generating circa £5million savings annually.

#### **6 EQUALITY AND SUSTAINABLE DEVELOPMENT IMPLICATIONS**

- 6.1 The decisions highlighted in this report have no direct equality implications. A sensible and robust reserve usage strategy does however underpin sustainability of the organisation.

#### **7 CONSULTEES**

Strategic Leadership Team

All Cabinet Members  
All Select Committee Chairman  
Head of Legal Services  
Head of Finance

**8 BACKGROUND PAPERS**

None

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