General and Earmarked Revenue Reserves Policy

Introduction

1. The Council holds revenue reserves to provide cover for risks and unforeseen events, to meet known or predicted requirements and to manage timing differences in funding. Reserves form a key part of the council's financial resilience and maintaining its financial sustainability.
2. The Council operates three funds – the General Fund, the Housing Revenue Account (HRA) and the Collection Fund. The HRA relates to the provision and maintenance of council housing and operates on a self-financing basis. The Collection Fund relates to the council acting as a billing authority for Southampton in the collection and distribution of council tax and business rates. All other activities of the council sit within the General Fund. This reserves policy is for the General Fund.

Legislative Framework

3. The council is required to set a balanced budget each year under Section 31A of the Local Government Finance Act 1992, which includes having regard to the level of reserves needed for meeting estimated future expenditure when calculating the council tax requirement.
4. Section 151 of the Local Government Act 1972 requires each local authority to make arrangements for the proper administration of their financial affairs and that the chief finance officer (also referred to as the section 151 officer) has responsibility for the administration of those affairs.
5. Under section 25 of the Local Government Act 2003, the S151 officer has a duty to report on the robustness of estimates and adequacy of reserves when the authority is considering its council tax requirement.
6. Section 114 of the Local Government Finance Act 1988 requires the S151 officer to report to all the authority's councillors if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that the authority will not have the resources to meet its expenditure in a particular financial year.
7. Section 26 of the Local Government Act 2003 gives the Secretary of State a general power to set a minimum level of reserves for local authorities. However, the government has undertaken to apply this only to individual authorities in the circumstances where an authority does not act prudently, disregards the advice of its chief finance officer and is heading for serious financial difficulty.

Types of Reserve

8. The council holds two types of revenue reserve:
    i. General Fund Balance – this operates as a working balance to manage the impact of uneven cash flows and avoid unnecessary temporary borrowing, and to provide a contingency against emerging events or emergencies. CIPFA recommend a minimum balance of 5% of net revenue expenditure.

ii. Earmarked Reserves – These are sub reserves/earmarked portions of the General Fund Balance and are used as a means of building up funds for use in a later financial year for known or predicted requirements. Table 1 sets out different types of earmarked reserves the Council may hold.

Table 1 – Types of Earmarked Reserves

Type of Earmarked Reserve	**Rationale**
Sums set aside for major schemes, such as capital developments or asset purchases, or to fund major reorganisations	Where expenditure is planned in future financial years, it is prudent to set aside resources in advance.
Insurance Reserves	Where self-insurance mechanisms are used, in the absence of any statutory basis, sums held to meet potential and contingent liabilities are reported as earmarked reserves where these liabilities do not meet the definition of a provision.
Reserves of trading and business units	Surpluses arising from in-house trading may be retained or may have to be retained by statute to cover potential losses in future years, or to finance capital expenditure. Eg Building Control
Reserves retained for service directorate use	Authorities may have internal protocols that permit year-end under-spendings to be carried forward.
Reserves established to manage corporate priorities	It may be necessary to set up earmarked reserves to manage specific across directorate priorities including transformation, responses to cross directorate policy issues, authority infrastructure etc.
Reserves for unspent revenue grants	Where revenue grants have no conditions or where the conditions are met, and expenditure has yet to take place.
Schools' Balances	These are unspent balances of budgets delegated to individual schools.
General contingencies to manage risk	Although various reserves may be established to manage individual risks, chief finance officers may want to establish contingencies to manage corporate risks including areas of high demand or need, the treatment of inflation and interest rates, property management, the treatment

	of planned efficiency savings/productivity gains, likelihood of incidents such as flooding etc.

Source: CIPFA Bulletin 13

9. Earmarked reserves are reported separately but remain legally part of the General Fund. As the statutory reserve is the General Fund Balance, it is possible within this balance for earmarked reserves to have debit balances. The council will only permit debit balances for earmarked reserves relating to statutorily ring-fenced sums, e.g. Schools' Balances.

Assessing the Adequacy of Reserves

10. To assess the adequacy of the General Fund Balance the S151 officer will carry out a risk assessment taking into account the strategic, operational and financial risks facing the council and the impacts they would have on the council's spending if they were to materialise. This risk assessment will be in the context of the council's overall approach to risk management and have regard to the council's risk register and medium term plans. The appropriate level of reserves to be 'adequate' is therefore not absolute, either as a £ amount or percentage of the budget but will vary depending upon the degree of financial risks faced.
11. In assessing the level of General Fund Balance in formulating the Medium Term Financial Strategy (MTFS) and annual budget, the S151 officer will consider the key financial assumptions underpinning the budget. Table 2 sets out the significant budget assumptions that are relevant when considering the adequacy of reserves.

Table 2 Budget assumptions and management assessment of impact on financial position

Budget assumptions	**Financial Position and management assessment of impact**
The treatment of inflation and interest rates	The overall financial position of the authority (level of borrowing, debt outstanding, council tax collection rates etc). Rises in the prices of some commodities, eg fuel and energy, highlight the relevance of using a number of inflation rates in the budget and financial strategy, and considering whether general reserves are adequate to deal with unexpected increases. Volatility in the financial markets also points to the need to consider investment and borrowing risks and their impact on income.
Estimates of the level and timing of capital receipts	The authority's track record in budget and financial management including the robustness of the medium-term plans. Authorities will also need to take into account changes in the property market, and adjust estimates and assumptions for reserves accordingly.

The treatment of demand led pressures	The authority's capacity to manage in-year budget pressures, and its strategy for managing both demand and service delivery in the longer term.
The treatment of planned efficiency savings/productivity gains	The strength of the financial information and reporting arrangements. The authority should also be able to activate contingency plans should the reporting arrangements identify that planned savings or gains will either not be achieved or be delayed.
The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital developments	The authority's virement and end of year procedures in relation to budget under/overspends at authority and department/directorate level. Risk management measures in relation to partnerships, including consideration of risk allocation. Contract provisions designed to safeguard the authority's position in the event of problems arising from outsourcing arrangements. Reserves may also need to be established to manage commercial risks where authorities have invested in commercial properties
The availability of reserves, government grants and other funds to deal with major contingencies and the adequacy of provisions	The adequacy of the authority's insurance arrangements to cover major unforeseen risks. When considering insurance cover, the structure of the cover as well as the overall level of risk should be taken into account. Risk assessments should be used when balancing the levels of insurance premiums and reserves.
The general financial climate to which the authority is subject	External factors, such as future funding levels expected to be included in Spending Reviews and expected referenda principles and limits, will influence an authority's ability to replenish reserves once they have been used. Any plans for using reserves will need to consider the need and ability of the authority to replenish the reserves, and the risks to which the authority will be exposed whilst replenishing the reserves.

Source: CIPFA Bulletin 13

12. A review of the levels of earmarked reserves will be undertaken in formulating the MTFS and annual budget. This will help inform the level of General Fund Balance required.
13. The S151 officer will advise on the adequacy of reserves over the lifetime of the MTFS, taking into account the expected need for reserves in the longer term. As reserves are one-off in nature, revenue reserves will not normally deployed to finance recurrent expenditure. Where such action is to be taken this will be made

explicit, and an explanation given as to how such expenditure will be funded in the medium to long term.

SCC Earmarked Reserves

14. Table 3 sets out the existing earmarked reserves held by the council, together with their purpose and how they can be used. All earmarked reserves will be reviewed at least annually to ensure that they are still appropriate, relevant and adequate for the intended purpose.
15. The S151 officer can allocate sums of any value to or from reserves, following the relevant consultation, in accordance with Financial Procedure Rules.
16. Any new earmarked reserves or change in purpose of earmarked reserves require Cabinet approval, upon recommendation from the S151 officer.

Table 3 SCC Earmarked Reserves

Reserve	**Purpose/Use**
Medium Term Financial Risk Reserve	Sums set aside on a non-recurrent basis to mitigate risks of changes to the local government funding system, volatility of local taxation, demand pressures and the potential for savings to be delayed. In addition, sums may be set aside in the reserve to pump prime transformation or invest to save measures, to meet the financial costs of redundancies as a result of organisation design changes and for other one-off corporate requirements. Examples of the latter may include to meet school deficits upon transfer to academy status and fluctuations in value of pooled investment funds (once the statutory requirement for these to be held in an unusable reserve ends in March 2025). This reserve is the first call on the council’s resources to deal with any unforeseen in-year expenditure if the centrally held contingency budget insufficient. Any outturn surpluses will be credited to this reserve.
Revenue Contributions to Capital Reserve	Sums set aside from the revenue budget to finance capital expenditure. To be used in line with planned financing of the capital programme or as a replacement for capital receipts if

	disposal proceeds are delayed or reduced.
Revenue Grants Reserve	For the carry forward of revenue grants that have no conditions or where the conditions are met, and expenditure has yet to take place, in accordance with recommended accounting practice.
Directorate Carry Forwards Reserve	Carry forward of budget underspends as approved by Full Council in accordance with Financial Procedure Rules. Where the overall outturn for the General Fund is a net deficit no budget carry forwards will be permitted. Budget carry forwards for individual directorates will only be permitted where the directorate has an underspend at outturn. This is in line with the cash limited operating model
PFI Sinking Fund	The reserve holds surplus PFI grant for use in meeting future contract liabilities and additional costs that might arise from reviewing or restructuring the council's PFI arrangements.
Insurance Reserve	This reserve holds monies to meet the potential cost of liability claims against the council, including motor and third party injury, however, there is no commitment on the council to pay the claim.
On Street Parking Account	It is a legal requirement to set aside surplus income from on street parking to be used in future years in accordance with the Road Traffic Regulation Act 1984.
DSG Reserve	The reserve holds in-year underspends on the Dedicated Schools Grant (DSG) to be used in future years. Cumulative and in-year overspends on DSG are held in an unusable reserve (DSG Adjustment Account) in accordance with regulations (the statutory override ends in 2025/26)
Schools' Balances	The scheme of Local Management of Schools (Education Reform Act 1988) requires the carry forward of individual schools' surpluses and deficits.
Other Reserves: For asset purchases: - Solar PV Sinking Fund Reserve	 To build up funds for the replacement of solar panels.

- Cremator Replacement Reserve	To build up funds for the replacement of the cremator at the crematorium.
Ring-fenced sums:	
- Bus Lane Enforcement Reserve	The reserve holds any surplus from drivers illegally using bus lanes. In accordance with legislation the reserve can be used to repay the General Fund for any deficits incurred in the preceding 4 years, to meet costs in providing or operating public passenger transport, or used to fund highways improvement projects.
- Building Competition Account	Legislation requires that building control competition activity should break even over a rolling period through recovery of costs. The reserve is used to manage any annual surpluses or deficits and for reinvesting in the building control service.
- Port Health Reserve	Legislation requires that fees for certain services within port health must be set on the basis of cost recovery and that any over-recovery is used to reduce future fees or invested in the service. Fees are reviewed annually to demonstrate ongoing cost recovery and the current surplus held within the reserve, built up during 2018/19, is being used to improve the resilience of the service.
- Public Health Reserve	To carry forward any unused ring-fenced Public Health Grant. This is held separately from other grant carry forwards for external reporting purposes.

Approach

17. The intention is to move towards a position where reserves are not used for balancing the budget but are for non-recurrent purposeful investment or spend and to ensure that there is financial provision set aside to meet known future one-off commitments or liabilities. They are also held as a means of ensuring financial resilience against unknown events and risks.

18. Given the fact the existing reserves were highlighted as inadequate in the budget report tabled at Council for 2023/24, financial planning will also focus on rebuilding reserves, over time, to a level considered adequate by the S151 officer.

Disposal of Assets

19. The council will consider disposal of assets where appropriate as a means to supplement resources, in particular to pay for ‘one off’ costs such as transformation.
20. An assessment will be made on any proposed disposal to determine if it represents value for money to dispose of, compare with the option of retention, using to redeem or avoid borrowing, support service transformation, or any other potential option.

Other one-off gains

21. The council will start to build reserves by setting aside one off gains which can then be utilised in a planned manner to provide the funds for purposeful investment, that reduces the financial burden to the council in the future.

The drawdown of reserves should always be in a planned manner whilst ensuring that reserves are not being used to support ongoing expenditure. The general fund balance is at the lowest CIPFA recommend, should not be used to support ongoing expenditure, if it is utilised at any point a plan should be brought forward to Cabinet to replenish the fund at the earliest opportunity.