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COMISIYNYDD HEDDLU A THROSEDDU



**DYFED-POWYS**

POLICE & CRIME COMMISSIONER

**REPORT / SUMMARY DECISION SHEET**

**PURPOSE:** COMMISSIONER DECISION

**Timing:** Urgent (Required in support of the budget setting process)

**Title:** Reserves and Balances Policy

**Category of Decision / Business Area Impact:** Finance – Financial Accounting / Governance

**Executive Summary:**

The Financial Management Code of Practice states that the Police and Crime Commissioner (PCC) should establish a policy on reserves (including how they might be used by the Chief Constable (CC)) and provisions in consultation with the CC.

The attached Reserves and Balances policy has been compiled in accordance with relevant statutory requirements, guidance and best practice.

**Recommendation:**

The Police and Crime Commissioner is asked to consider and approve the attached "Reserves and Balances Policy".

**Police and Crime Commissioner for Dyfed-Powys**

I confirm I have considered whether or not I have any personal or prejudicial interest in this matter and take the proposed decision in compliance with the Nolan Principles for Conduct in Public Life.

The above has my approval / does not have my approval.

**Signature:**

**Date:**

24/5/2013

**Police and Crime Commissioner for Dyfed Powys Police**

# **RESERVES & BALANCES POLICY**

## **1. Purpose of the Reserves and Balances Policy**

- 1.1. The requirement for financial reserves is acknowledged in statute. Sections 32 and 43 of the Local Government Finance Act 1992 require local authorities in England and Wales to have regard to the level of reserves needed for meeting estimated future expenditure when calculating their budget requirement.
- 1.2. Reserves are an essential part of financial management. They help the PCC and CC cope with unpredictable financial pressures and plan for future spending commitments.
- 1.3. The Financial Management Code of Practice states that the Police and Crime Commissioner (PCC) should establish a policy on reserves (including how they might be used by the Chief Constable (CC)) and provisions in consultation with the CC. This should have due regard to the need to ensure the on-going funding of policing activities and the requirement to meet exceptional or extraordinary policing operations.

## **2. Definitions**

- 2.1. Reserves and balances are different from provisions from an accounting perspective. In the case of useable reserves (as opposed to unusable reserves) and provisions, both amounts represented on the balance sheet should be matched by physical cash balances, unless internal borrowing has taken place.
- 2.2. **Usable Reserves** – are balances which are generally held for three specific purposes and are categorised as general reserves or earmarked reserves:
  - A working balance to help smooth the impact of uneven cash flows – general reserves.
  - A contingency to deal with unexpected events – general reserves.
  - A means of building up funds to meet known or predicted requirements – earmarked reserves.
- 2.3. **Unusable Reserves** - do not have equivalent cash balances and are held for accounting purposes.
- 2.4. **Provisions** – are required for any liabilities of uncertain timing or amount that have been incurred.

## **3. Governance Arrangements**

- 3.1. Minimum governance requirements in respect of reserves and balances are:
  - The PCC has a soundly based policy on the level and nature of reserves and balances it needs which has been considered and approved by the Joint Audit Committee.
  - The required levels of reserves and balances should be reflected in the annual budget and Medium Term Financial Plan (MTFP).
  - The PCC monitors and maintains its levels of reserves and balances within the range determined by its agreed policy, advised by the CFO (PCC) who will ensure that there are clear protocols for their establishment and use.

- The PCC retains adequate reserves so that unexpected demand led pressures on budgets can be met without adverse impact on the achievement of the key priorities.
  - The PCC's policy for reserves and balances is based on a thorough understanding of needs and risks, and is properly and clearly reported at the time the budget and precept are set. The level of balances is kept under review and managed to ensure that financial standing is sound and supports the PCC in the achievement of their long term objectives.
  - Where target levels for reserves and balances are exceeded, the opportunity costs of maintaining these levels has been established, compared to the benefit accrued.
- 3.2. Locally agreed Financial Regulations and the Scheme of Consent should:
- Contain full details of how the Reserves and Balances Policy will operate locally;
  - Ensure that the annual budget includes a realistic amount of operational contingency that is available to the CC for operational priorities without the need for additional approval; and
  - Make provision, where appropriate, for budgets to be carried forward from one financial year to the next.

#### **4. Statutory Responsibilities**

- 4.1. The "CIPFA Statement on the Role of the Chief Finance Officer of the Police and Crime Commissioner and the Chief Finance Officer of the Chief Constable" sets out the five principles that define the core activities and behaviours that belong to the role of the CFO and the organisational arrangements needed to support them.
- 4.2. For each principle the Statement sets out the governance arrangements required within an organisation to ensure that CFOs are able to operate effectively and perform their core duties.
- 4.3. Governance arrangements required in respect of reserves and balances and which are the responsibility of the CFO (PCC) are:
- Ensuring that advice is provided on the levels of reserves and balances in line with good practice guidance.
  - To report at the time the budget is considered and the precept set, on the robustness of the budget estimates and the adequacy of financial reserves, as required by s25 of the Local Government Act 2003, and in line with CIPFA guidance.
- 4.4. Both should be undertaken in consultation with the CFO (CC).
- 4.5. There are also a range of safeguards in place that militate against the PCC over-committing themselves financially. These include:
- The balanced budget requirement
  - Chief finance officers' Local Government Finance Act 1988 Section 114 powers which requires the chief finance officer to report if there is or is likely to be unlawful expenditure or an unbalanced budget; and

- The external auditor's responsibility to review and report on financial standing includes a review of the level of reserves taking into account their knowledge of the organisation's performance over a period of time. However, it is not the responsibility of auditors to prescribe the optimum or minimum level of reserves for individual organisations.

**5. Assessing the appropriate level of reserves**

- 5.1. The PCC is responsible for ensuring that the level of reserves is appropriate for local circumstances, and is accountable to taxpayers for the decisions made. The CFO (PCC) has a duty to provide the PCC with the advice they need to make good decisions.
- 5.2. Reserves are maintained as a matter of prudence. They enable the organisation to provide for cash flow fluctuations and unexpected costly events and thereby help protect it from overspending the annual budget, should such events occur. Reserves for specific purposes may also be maintained where it is likely that a spending requirement will occur in the future.
- 5.3. The public's acceptance of the precept is partly reliant on the understanding that the precept is spent on policing and that only a reasonable and prudent amount of any over-funding is being stored away as a general reserve. Conversely, when unforeseen expenditure arises, it is likely that the public would expect that the organisation would have sufficient resources to cover the expense without recourse to overspend.
- 5.4. In order to assess the adequacy of reserves, the CFO (PCC) should include an up-to-date assessment of the strategic, operational and financial risks facing the organisations.
- 5.5. Setting the level of reserves is one of several related decisions that must be taken when preparing the MTFP and the budget for a particular financial year.
- 5.6. Assessing the required level of reserves should involve carrying out an analysis of the Balance Sheet on an annual basis and projecting forward the key items of the Balance Sheet. This projection incorporates forecasting levels of reserves and balances over a three year time horizon to cover the MTFP and capital programme.
- 5.7. An effective reserves and balances strategy should consider the organisations approach to treasury management, capital expenditure plans and the need for external borrowing, against the use of balances and reserves.
- 5.8. CIPFA guidance suggests that in addition to cash flow requirements, the following factors should be considered:

| Budget Assumptions   | Financial Standing and Management  |
|--|--|
| The treatment of inflation and interest rates  | The overall financial standing of the organisations (level of borrowing, debt outstanding, council tax collection rates etc.)          |
| Estimates of the level and timing of capital receipts  | The organisations track record in budget and financial management including the robustness of the medium term plans.                   |
| The treatment of demand led pressures  | The organisations capacity to manage in-year budget pressures  |
| The treatment of planned efficiency savings/ productivity gains  | The strength of the financial information and reporting arrangements   |
| The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital developments | The organisations virement and end of year procedures in relation to budget under/over spends at organisational and departmental level |
| The availability of other funds to deal with major contingencies and the adequacy of provisions  | The adequacy of the organisations insurance arrangements to cover major unforeseen risks.  |

## 6. Earmarked Reserves

- 6.1. The current accounting Code requires the purpose, usage and basis of transactions of earmarked reserves to be clearly identified. A review of the purpose and level of reserves will be carried out annually during the budget setting process and details of the use of reserves included in the relevant note to the Statement of Accounts.
- 6.2. It is the PCC's policy to use reserves to fund non-recurring purchases to reduce the impact on the council tax precept. The target level of earmarked reserves will therefore fluctuate annually but will always be justifiable and monitored to ensure levels of earmarked reserves are not too high or too low.
- 6.3. Earmarked reserves are categorised as either "usable" reserves or "unusable" reserves. Usable reserves can be applied to fund expenditure, unusable reserves are not resources backed and therefore do not have equivalent cash balances.
- 6.4. The reason useable reserves are held will be classified as:

| Specification                  | Reason   | Proportion of Net Revenue Expenditure Budget  |
|--------------------------------|--|---|
| Earmarked - specified          | For a specific purpose   | Assessment based  |
| Medium Term Financial Planning | To plan finances strategically e.g. reserves to defer external borrowing to secure financial savings   | Assessment based  |
| Capital Spending               | To support the capital programme   | Assessment based  |
| Corporate contingency          | To protect against overspends or failure to deliver savings on time.   | 2%  |
| Risk-based reserves            | <ul style="list-style-type: none"> <li>- Held to cover short-term financial risk</li> <li>- Held for medium and long-term risks or spending plans</li> </ul> | 3% to 5%  |
| Ring fenced income             | That can only be used for specific purposes  | Carry forward of unspent ring-fenced income from one financial year to the next in accordance with the Code |

6.5. Unusable reserves currently held include:

- **Revaluation Reserve** - The Revaluation Reserve contains the gains arising from increases in the value of Property, Plant and Equipment and Intangible Assets. The balance is reduced when assets with accumulated gains are revalued downwards or impaired, consumed through depreciation, or disposed of and the gains are realised.
- **Capital Adjustment Account** - The Capital Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for the consumption of non-current assets and for financing the acquisition, construction or enhancement of those assets under statutory provisions.
- **Accumulated Absences Account** - The Accumulated Absences Account absorbs the differences that would otherwise arise on the General Fund Balance from accruing for compensated absences earned but not taken in the year, e.g. annual leave entitlement carried forward at 31 March. Statutory arrangements require that the impact on the General Fund Balance is neutralised by transfers to or from the Account.
- **Pensions Reserve** - The Pensions Reserve absorbs the timing differences arising from the different arrangements for accounting for post-employment benefits and for funding benefits in accordance with statutory provisions.



## **7. General Reserve**

- 7.1. Whilst CIPFA does not stipulate a minimum or optimal level of general reserve, its general guidance is to establish a reserve representing *“resources set aside for purposes such as general contingencies and cash flow management.”*
- 7.2. Historically, District Audit recommended that the general reserve is set at a minimum 2.5% of the net revenue expenditure budget. In addition the level of general reserves held by the Most Similar Forces will also be considered in determining the adequacy of the level of the general reserve held by the PCC. The general reserve should not exceed 4.5% of the net revenue expenditure budget.
- 7.3. Setting the level of earmarked and general reserves is just one of several related decisions in the formulation of the MTFP and the budget for a particular year. Account should be taken of the key financial assumptions underpinning the budget alongside a consideration of the organisations financial management arrangements.

## **8. Force reserves**

- 8.1. The PCC must have due regard to the need to ensure the on-going funding of policing activities (including the requirement to meet exceptional or extraordinary operations). The annual budget should include a realistic amount of operational contingency to be available to the Chief Constable to meet operational priorities without the need for additional approval.
- 8.2. The CC will ensure that the annual revenue budget is sufficient to finance foreseeable operational needs by presenting a business case as part of the MTFP and annual budget setting process to the CFO (PCC) and PCC for one-off expenditure items to be funded from earmarked reserves.
- 8.3. The business case should include consideration of the level of reserves required for major incident investigations and other operational requirements, the amount of reserves required and timescales for their use.
- 8.4. Approval of business cases for the use of reserves will be subject to the authorisation limits set out in Financial Regulations, to assist with day to day operational decision making.

## **9. OPCC Reserves**

- 9.1. Reserves should be held by the PCC and managed to balance funding and spending priorities and to manage risks. This should be established as part of the medium-term financial planning process.
- 9.2. During Stage 1, all reserves will be held by the PCC.
- 9.3. During Stage 2 the PCC will give Consent to the CC to undertake certain functions without the need to seek prior approval. Transactions entered into following consent by the PCC to the CC will be in the CC's own name as a separate legal entity as opposed to the name of the PCC, as would be the case for delegated authority.
- 9.4. Consideration will be required prior to Stage 2 as to which reserves will be held in the CC's balance sheet.

## **10. Reporting Framework**

10.1. The PCC has a fiduciary duty to local taxpayers and must be satisfied that the decisions taken on balances and reserves represent proper stewardship of public funds.

10.2. The level and utilisation of reserves will be determined formally informed by the advice and judgement of the CFO (PCC). To enable the PCC to reach their decision, the CFO (PCC) will report the factors that influenced their judgement and ensure that the advice given is recorded formally. This report will include as a minimum a statement:

- detailing the level of general reserve and any movements on the fund;
- on the adequacy of the earmarked reserves, relative to spending and an estimate of provisions in respect of the forthcoming financial year and the MTFP;
- how reserves have changed over time, comparing with those held by other similar organisations;
- on the annual review of earmarked reserves including estimates of the year end balances. The statement will list the various reserves, their purpose, when they will be utilised and appropriate level; and
- An assessment of the risk of major incidents (operational and non-operational) occurring which is reflected in the budget and MTFP.

10.3. This report will be provided annually based on estimates to the PCC prior to approval of the council tax precept. The report will be updated with the year-end position for the PCC prior to the approval of the Statement of Accounts.

10.4. A mid-year report will be provided to the PCC for monitoring purposes. This will set out any changes in the status of the risks that reserves are being held to mitigate.

## **11. The “Opportunity Cost” of Holding Reserves**

11.1. The external auditor encourages a statement within the Reserve Policy on the opportunity cost of holding reserves. “Opportunity Cost” is an economic theory term, which means if you spend something on one thing you can’t spend it on something else.

11.2. Applied to reserves, this means that if reserves are held which are too high, then an organisation is foregoing the opportunity to lower the Council Tax. This theory does not however lend itself well in practice where levels of council tax increase can be capped.

11.3. During the budget setting process the PCC considers using reserves for one off investments. This is considered a more sustainable use of ‘excess’ reserves and reduces the impact on the council tax precept.

11.4. It is essential that the PCC’s decisions on reserves are communicated clearly to local taxpayers to promote accountability.

## 12. Provisions

12.1. Provisions are required for any liabilities of uncertain timing or amount that have been incurred. Provisions are required to be recognised when:

- a. the local authority has a present obligation (legal or constructive) as a result of a past event
- b. it is probable that a transfer of economic benefits will be required to settle the obligation, and
- c. a reliable estimate can be made of the amount of the obligation.

12.2. A transfer of economic benefits or other event is regarded as probable if the event is more likely than not to occur. If these conditions are not met, no provision should be recognised.

12.3. The requirement for provisions will be assessed and reported upon at the same time as the reserves.

## 13. Responsibilities for reserves and balances

|  | PCC | GEO | CC | CFO (PCC) | CFO (CC) |
|--|-----|-----|----|-----------|----------|
| To advise the PCC on reasonable levels of balances and reserves.   |     |     |    | ✓         |          |
| To report to the PCC on the adequacy of reserves and balances before he approves the annual budget and council tax.  |     |     |    | ✓         |          |
| To approve appropriations to and from each earmarked reserve. These will be separately identified in the Annual Statement of Accounts.                     |     |     |    | ✓         |          |
| To ensure that the annual revenue budget is sufficient to finance foreseeable operational needs without having to request additional approval.             | ✓   |     | ✓  |           |          |
| To present a business case to the CFO (PCC) and PCC for one-off expenditure items to be funded from earmarked and/or general reserves.                     |     |     | ✓  |           |          |
| To approve a policy on reserves and balances, including lower and upper parameters for the level of general balances                                       | ✓   |     |    |           |          |
| To approve the creation of each earmarked reserve. The purpose, usage and basis of transactions should be clearly identified for each reserve established. | ✓   |     |    |           |          |
| To approve the allocation of monies to and from general and earmarked reserves, as part of the annual budget setting process.                              | ✓   |     |    |           |          |

#### **14. Impact Consideration**

| <b>Implication</b>               | <b>Impact Considered<br/>(Yes/No)</b> | <b>Impact Identified<br/>(paragraph reference)</b> |
|----------------------------------|---------------------------------------|--|
| Legal                            | Yes                                   | Paragraph 4  |
| Financial                        | Yes                                   | Report   |
| Race and Equality                | Yes                                   | N/A  |
| Human Rights                     | Yes                                   | N/A  |
| Environmental and Sustainability | Yes                                   | N/A  |
| Risk Analysis                    | Yes                                   | Report   |
| National Park Implications       | Yes                                   | N/A  |

#### **15. Appendices**

None applicable

#### **16. Background papers**

- CIPFA Statement on the Role of the Chief Finance Officer in Local Government.
- Police and Crime Panel Report – “Initial Precept/Budget for 2013/14 and Financial Outlook to 2017/18” dated 25<sup>th</sup> January 2013.

#### **17. Contact details**

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