



# MEDSTEAD PARISH COUNCIL

## Financial Reserves Policy

### 1. Purpose

The Local Government Finance Act 1992 requires local authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement. The purpose of this policy is to set out how Medstead Parish Council will determine, review and manage the level of reserves.

The Parish Council has no legal powers to hold reserves other than for reasonable working capital needs or for specifically earmarked purposes. Reserves help the council to set aside funds for unforeseen costs, to maintain financial security and avoid temporary loans when faced with cash flow delays. They allow the council to plan for future projects such as renewal and maintenance of infrastructure whilst avoiding large year on year fluctuations in the precept, and they provide better financial transparency to the electorate.

### 2. Types of Reserve

There are two types of reserves that the council may hold, categorised as general and earmarked reserves.

- General reserves are held to cushion the impact of uneven cashflow or unexpected events
- Earmarked Reserves are held for specific purposes.

(Whilst these terms are widely used by other councils as well as Medstead Parish Council, it is worth noting that general reserves are sometimes referred to as unallocated reserves, and earmarked reserves are sometimes called allocated reserves, specific reserves, designated reserves, nominated reserves or ring-fenced reserves).

### 3. General Reserves

General Reserves do not have any restrictions as to their use. They can be used to smooth the impact of uneven cash flows - a common occurrence since the precept is only paid twice per year, grant income is often paid after expenditure has been incurred, and the precept and grant income are paid net of VAT, which is claimed in arrears. General reserves can also offset unavoidable budget overspend if necessary or can be held in case of unexpected events or emergencies.

The primary means of building up the General Reserve is through an allocation in the annual budget. This will be in addition to any amounts needed to replenish reserves that have been consumed in the previous year.

There is no legal minimum or maximum level of general reserves, but guidance recommends that a council should typically hold between 3- and 12-months net revenue expenditure as a general reserve (e.g. The Good Councillor's Guide on Finance & Transparency and the Joint Panel on Accountability and Governance (JPAG) Practitioner's Guide 2024, which sets out the 'proper practices' for how the council must maintain its accounts). Net revenue expenditure is defined as the precept, less amounts included in the precept for loan repayment, capital projects and transfers to reserves.

The reason for the wide range is to cater for the large variation in activity level between individual authorities. According to the JPAG Practitioner's Guide 2024, the smaller the authority, the closer the figure may be to 12 months expenditure, the larger the authority, the nearer to 3 months. (It says that in practice, any authority with income and expenditure in excess of £200,000 should plan towards 3 months equivalent general reserve). Larger authorities normally have more predictable income and outgoings and greater flexibility, and one-off events represent a smaller proportion of expenditure.

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. If a council's general reserve were significantly higher than the precept it would likely be required to provide an explanation to the Auditor.

Where the general reserves have been insufficient or depleted in previous years, the council has several ways (in combination) to increase it – to cut the revenue budget or earmarked reserves in other areas, to generate more income (including grants), to make a large step increase in the precept to increase general reserves in a single year, or to make a smaller step increase in precept to reach the target over two or more years. Such decisions have to be taken at the time of each annual budget, taking all factors into account and assessing the degree of urgency. However, it should be noted that Medstead Parish Council has limited scope to increase income (excluding grants) or to cut the revenue budget without serious detriment to community services.

The level of General Reserve is a matter of judgment that will vary with circumstances each year, and so this policy does not attempt to prescribe an exact level for Medstead Parish Council at all times. Starting from a level of very low general reserves, as a first step, the Council aims to at least build the recommended minimum level of three months of net revenue expenditure through an allocation in the precept, recognising that it may take more than one financial year of precept increases to reach this level. A council of Medstead's size should hold around 6-9 months of net revenue expenditure and this should be factored into future precept requests, as well as decisions on how to spend CIL money. Some earmarked projects may be able to appropriately draw on CIL funds instead of earmarked reserves.

During the budgeting process each year, the Council's Risk Assessment should be taken into account, considering all the financial risk factors affecting the council's main areas of income

and expenditure and any provisions and contingencies that may be required. There will be many factors, but key risks to consider will include:

- Salary inflation greater than budgeted
- Contractual inflation greater than budgeted
- Income levels below budgeted level
- Unexpected costs incurred due to staff illness or loss
- Unexpected essential repairs or maintenance work
- Unexpected need for legal or other professional services
- Impact of losses of uninsurable items or insurance excesses

The risks will be higher at times of economic uncertainty or when there are major projects planned or in progress. The judgement on the level of general reserves needs to be done on an annual basis, but it is beneficial to the council and the electorate to avoid both widely fluctuating levels of general reserves and a widely fluctuating precept whenever possible, and it helps the electorate better understand how their tax money is being used.

Approval of the full council is required to spend funds in the general reserve or to move funds into earmarked reserves or other budget allocations. The processes for authorising and approving expenditure are covered by the council's financial regulations.

If the General Reserve is exhausted due to extreme circumstances, the Council may make emergency borrowings from other Earmarked Reserves, which will be replaced in the next annual budget.

Even at times when extreme pressure is put on the Council's finances the Council must keep a minimum balance sufficient to pay three month's salaries to staff in General Reserves at all times.

Any surplus of general reserve above the required balance in any year may be used to fund capital expenditure, be appropriated to earmarked reserves or used to limit any increase in the precept.

#### **4. Earmarked Reserves**

Earmarked Reserves will be established on a "needs" basis in line with anticipated requirements to meet known or predicted liabilities. Earmarked Reserves must be reviewed and / or established by the Council at the annual budget setting meeting.

The council may hold Earmarked Reserves in the following categories:

- Carry forward of underspend, where some expenditure is budgeted for projects but not spent in that financial year. Reserves are used as a mechanism to carry forward these resources.
- Reserves built up over a time period, for example to plan and finance an effective programme of infrastructure replacement or infrastructure / property maintenance or other future expenditure such as an election. The setting aside of funds each year over a period of time in earmarked reserves to meet known future expenditure is a

mechanism to smooth expenditure so that a sensible replacement programme can be achieved without the need to vary budgets dramatically from year to year.

- Unpaid bills: At the end of the year some bills might not have been paid, or expenditure has been delayed for some short-term reason.

Expenditure from earmarked reserves can only be authorised by the full council at a Parish Council meeting. The processes for authorising and approving such expenditure are the same as for expenditure within the revenue budget, as defined in the council's financial regulations.

Where the purpose of an earmarked reserve becomes obsolete, or where there is an over-provision of funds, the excess may, by Council resolution only, be transferred to other budget headings within the revenue budget or to the General Reserves or to one of more other Earmarked Reserves. This is effectively a two stage decision where the earmarked reserve returns to the general reserve and then is reallocated.

There is no statutory upper limit on the level of earmarked reserves, save that they must be held for genuine and intended purposes. As earmarked reserves are often built up over several years for future projects, during the budgeting process the Council needs to have a strategic view of what it plans to do three years (or more) in the future.

Reserves should not be held to fund ongoing expenditure. This would be unsustainable, as at some point the reserves would be exhausted. If reserves are used to meet short term funding gaps, they must be replenished in the following year. However earmarked reserves that have been used to meet a specific liability would not need to be replenished, having served the purpose for which they were originally established.

Medstead Parish Council also receives money from S106 and CIL funds. When considering its required level of earmarked reserves during the annual budgeting process, the council needs to be careful about treating S106 and CIL funds appropriately. S106 and CIL grants from the local planning authority are only allocated for specific projects, typically paid in arrears. The funds are not guaranteed until a grant application has been approved, often with a considerable time lag, and funds should not be assumed until approved. In contrast the Neighbourhood Portion of CIL funds is allocated to the parish Council, but caution is also needed over allowed uses.

CIL Regulation 59C sets out that a local council must use CIL receipts passed to it to 'support the development of the local council's area, or any part of that area, by funding: a) the provision, improvement, replacement, operation or maintenance of infrastructure: or b) anything else that is concerned with addressing the demands that development places on an area'.

In some cases, Neighbourhood CIL may be appropriately used for projects that might otherwise require an earmarked reserve. The Council has to report on how it uses its CIL receipts, and inappropriately used funds are liable for clawback. Also, Neighbourhood CIL money will be clawed back if not spent within five years of receipt, so cannot be used instead of earmarked reserves for a project a long way ahead. Despite these limitations, the

neighbourhood CIL and S106/CIL grants are a valuable source of funds and should be strategically considered when determining the level of earmarked reserves required.

Income in reserves from the sale of fixed assets ('capital receipts') such as the sale of land, can only be used for other capital projects.

## **5. Management and control of reserves**

It is the responsibility of the Responsible Financial Officer to advise the Parish Council about the creation, amendment, cessation and continuation of reserves and their level, and to ensure that there are procedures for their establishment and use.

The level of general and earmarked reserves held by the council will be agreed by the council during the discussions held regarding the setting of the budget for the next financial year. The RFO will undertake a review of requirements, costs, the risk assessment and the Council's strategic plans and timescales, with each earmarked reserve considered individually. For existing earmarked reserves, the RFO will check each earmarked reserve is still required and that the level is still appropriate. When considering reserves for replacement of equipment or infrastructure, the council needs to give consideration to the effect of inflation on the original purchase price.

The RFO will maintain a schedule of earmarked reserves within the accounting records, which must be separately identified together with their amounts and descriptions of their purpose and intended timescales. It is good practice to include this on the website as it provides a means of communicating financial plans to the public.

Movements in earmarked reserves and general reserves shall be reported to the Parish Council at full council meetings along with the review of the revenue budget at least quarterly, and at monthly meetings if required.

Reserves effectively lose value over time due to inflation so an effort must be made to spend earmarked reserves for projects within a reasonable time and to earn interest on funds where possible.

The level of general and earmarked reserves should be reviewed at the end of the financial year, to consider whether adjustments are needed and to report the reserves to the auditor in the end of year accounts.