REVIEW OF BALANCES / RESERVES

General Reserves

1.1 Local authorities are legally required to set a balanced budget and the chief finance officer has responsibilities to report to Council should serious problems arise (including in relation to the adequacy of reserves). External auditors are responsible for reviewing and reporting on financial standing but are not responsible for recommending a minimum level of reserves.

1.2 Under provisions introduced by the Local Government Act 2003, the level and use of reserves must be formally determined by the Council, informed by the judgement and advice of the chief finance officer. When calculating the budget requirement, the chief finance officer must report to Members on the adequacy of reserves. There are also now reserve powers for the Secretary of State to set a minimum level of reserves.

1.3 The Council needs to consider the establishment and maintenance of reserves as an integral part of its medium term financial strategy. Reserves are held for three main purposes:

- As a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of a general reserve.
- To hold funds for specific purposes or to meet known or predicted liabilities – these are generally known as earmarked reserves. Schools’ balances and insurance reserves are examples of these.
- As a contingency to cushion the impact of unexpected events or emergencies, including budget overspends – this also forms part of a general reserve.

1.4 In order to assess the adequacy of general reserves, account needs to be taken of the strategic, operational and financial risks facing the authority. The level of general reserves is also just one of several related decisions in the formation of a medium term financial strategy and the budget for a particular year. Factors affecting judgements about reserves include the key financial assumptions underpinning the budget and an assessment of the Council’s financial health, including:-

- Overall financial standing (level of borrowing, Council Tax collection rates, auditors’ judgements, etc.)
- The track record in budget management.
- Capacity to manage in-year budget pressures.
- The strength of financial information and reporting arrangements.
- The external financial outlook.

1.5 There is therefore no ‘correct’ level of reserves. Furthermore a particular level of reserves is not a reliable guide to the Council’s financial health. It is
quite possible for reserves to increase but for financial health to deteriorate, if
for example, the authority’s risk profile has changed.

1.6 Financial reserves also have an important part to play in the overall
management of risk. Councils with adequate reserves and sound financial
health can embark on more innovative programmes or approaches to service
delivery, knowing that if the associated risks do materialise the Council has
sufficient financial capacity to manage the impact. Conversely, Councils with
inadequate reserves can either find it more difficult to introduce change, or in
extreme cases can be forced to develop very high-risk service strategies
simply in order to restore their financial health.

1.7 General reserves are projected to stand at £13.8m as at 31st March 2006,
although this is before deducting costs arising from the ongoing Police
investigations into earlier financial irregularities.

1.8 The Council continues to face a range of uncertainties which carry attendant
financial risks. It remains highly dependent upon Government grant and
therefore has a high exposure to Formula Grant settlements, changes in
specific grant regimes, and/or tightening public finances. The Council also
has an ambitious improvement programme, and a number of major and
interdependent projects, with significant financial implications, which will
come to fruition in similar timescales over the next few years. These factors
point to the need for a solid financial position to underpin the risks involved.

1.9 Against this background, last year’s strategy of replenishing general reserves
remains prudent and appropriate.

**Insurance Reserve**

1.10 The Financial Outlook and Review identified continuing pressure on
insurance costs to meet both higher numbers of claims payments and higher
external insurance premiums. The Council self-insures a substantial
proportion of its insurable risks and an external actuarial review of the level of
internal insurance reserves is commissioned at regular intervals.

1.11 The last review examined current and potential liabilities and established the
level of reserves required based on three projections – a minimum level of
funding required to maintain solvency, a middle case based on the most likely
assessment of future claims, and a high case with a more pessimistic
projection of future claims. The recommended values associated with each
of these scenarios at current prices was:-

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<td>Minimum</td>
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<td>Middle Case</td>
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<td>High Case</td>
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The value of the Council’s insurance reserves and provisions was £23.6m at the end of 2004/05, just above the middle case scenario.

1.12 The next actuarial review of the fund is due at the beginning of 2006.

1.13 Contributions to the insurance reserve are made by all Directorates based on their relative size, risk profile, and level of claims, together with a corporate contribution related to overall funding levels. Annual contributions currently total £5.9m and no change to this is recommended for 2006/07.

**E-Government Loan Repayment**

1.14 On 6th December 2000, PIC (the former Policy Implementation Committee) provided £2.7m for the Public Service Strategy/E-Government in 2001/2002 on a one-off basis. These proposals entailed the temporary application of reserves and their eventual repayment with interest on the principle of Invest to Save. The repayments were agreed to be made from savings at a rate of £0.65m 2002/2003 and £0.689m each year from 2003/2004 to 2008/2009.

**Earmarked Reserve for Housing Choice**

1.15 The implications of housing stock reduction for the General Fund are set out in the body of this report. The Council has recognised the impact of these changes on its medium term financial strategy and has established a recurrent provision of £5m in the General Fund budget to fund transitional and ongoing costs.

1.16 The exact timing and magnitude of any additional costs involved cannot be predicted with certainty, as this will depend upon a range of factors, most significantly the scale, number and timing of stock transfers as determined by the Council’s tenants, and also the potential for making compensating cost savings.

1.17 The adequacy of the overall provision is subject to regular review. At the present time, the current provision of £5m is considered to be of the right order of magnitude and no change is proposed as part of the 2006/07 budget. However given the actual and expected stock reductions in 2006/07 application of £1.8m of the overall provision to fund General Fund services is recommended. The basis of this calculation is set out in earlier in this report.

**Parking Control Reserve**

1.18 The Parking Control Account (PCA) is ringfenced. The surplus can only be used for transport and highways initiatives, and for re-investment within the services. Tower Hamlets principally uses the surplus to part fund the cost of the concessionary fares scheme.

1.19 The PCA and the utilisation of the Parking Control Reserve are reviewed on an annual basis. The Parking Control Account currently contributes £2,510,000 towards the concessionary fares scheme. This is estimated to be the maximum level of contribution available in the next financial year.

**Schools’ Reserves**
1.20 Schools’ reserves represent unapplied revenue resources accumulated by schools with delegated spending authority. These totalled £17.7m at 31st March 2005. Schools’ reserves are technically earmarked reserves of the Council but are controlled by schools and are not available to the Council for other purposes.

Developer Contributions

1.21 The Council receives monies under agreements entered into under Section 106 of the Town and Country Planning Act 1990. These agreements specify the purposes to which the monies can be applied. Unapplied sums are held in an earmarked reserve until such time as they are applied.

Service Specific Earmarked Reserves

1.22 A number of earmarked reserves are held to meet specific service objectives or fund potential liabilities which do not qualify as provisions for accounting purposes. The principal ones provide for:-

- Dilapidations claims in respect of administrative buildings and premises utilised by the Homeless Persons Unit.
- Accumulated rate rebates on Education buildings to be applied to fund new capital investment.
- The carry-over of budgetary underspends from one financial year to the next.

Use of these reserves is subject to specific Cabinet approval. The nature of these reserves means they are not generally available to support the Council’s medium term financial strategy.