

ADVICE NOTE - Local Council Reserves and Balances

Following the introduction of the Accounts and Audit Regulations in 1996, which can be considered as the birth of the modern rules governing local council accounting and audit procedures, a question was asked in the House of Commons to the then Minister of Local Government regarding the level of reserves which a local council should maintain.

The answer given is still current – although Sections 32 and 43 of the Local Government Finance Act 1992 require billing and precepting authorities in England and Wales to have regard to the level of reserves needed to meet estimated future expenditure when calculating the budget requirement, statute or regulations do not dictate that a local council should maintain reserves of any particular size or, indeed, that they should maintain any at all. It is widely accepted that a case for a statutory minimum level of reserves, even in exceptional circumstances, has not been made. However, due prudence does require that reserves are built up and maintained.

When reviewing the medium term financial plans and preparing the annual budget the prudent local council will consider the establishment and maintenance of reserves. These will be held for three main purposes:

- a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing (overdraft) e.g. prior to receipt of precept – this forms part of general reserves,
- a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves,
- a means of building up funds, often referred to as earmarked reserves, to meet known or predicted liabilities.

With regard to the General Reserve, the question of size has often been asked. The advice to external auditors is that general (i.e. un-earmarked) revenue reserves usually lie within the range of three to twelve months gross expenditure but that the amount should be risk assessed and approved by the Council. The external auditor might still, and taxpayers would also be within their rights to, seek answers regarding the size of any General Reserve relative to the precept. Where a council's year-end General Reserve is significantly higher than the annual precept an explanation should be provided to the external auditor.

Earmarked Reserves are entirely different to the General Reserve and should be established whenever there is a need to "save up" for expected and significant future expenditure as it would be unwise to expect the taxpayer to fund a significant purchase in any one year. The funding for the purchase, for example, of a new vehicle or a new village hall should be "spread" over a number of years so that the total financial burden does not fall to the taxpayer in one single precept. Each year's precept should include an "instalment" which can be transferred to the earmarked reserve and used at the time the expenditure is needed. Earmarked Reserves not eventually spent on the purpose intended should not simply be transferred to the General Reserve but used to reduce the precept or for other capital expenditure in the current or next financial year.

Barrie Woodcock,

SLCC National Financial Advisor.

March 2009.