CIPFA

CIPFA Bulletin 13– Local Authority Reserves and Balances (Updated)

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CIPFA issues bulletins to assist practitioners with the application of the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code), the Service Reporting Code of Practice (SeRCOP) and the Prudential Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but they are not prescriptive and do not have the formal status of the Code, SeRCOP or the Prudential Code.

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The Chartered Institute of Public Finance and Accountancy (CIPFA) is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, major accountancy firms and other bodies where public money needs to be effectively and efficiently managed. As the world's only professional accountancy body to specialise in public services, CIPFA's qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. Globally, CIPFA leads the way in public finance by standing up for sound public financial management and good governance.

CIPFA Bulletin 13 – Local Authority Reserves and Balances

Introduction and background

1. LAAP Bulletin 55 (Guidance note on local authority reserves and balances) was issued in February 2003. This was followed by its replacement in 2008 by LAAP Bulletin 77. LAAP Bulletin 77 included a number of events and changes that occurred including the publication of the Prudential Code and the beginnings of the financial downturn. The IFRS-based Code[1] was published following the issue of LAAP Bulletin 77, and the bulletin was updated to reflect the new requirements of that Code. In addition, during a period of financial austerity for the public sector, the then Local Authority Accounting Panel considered that it was necessary to update the guidance on local authority reserves and balances. LAAP Bulletin 99 was issued in July 2014.

2. CIPFA Bulletin 13 has been updated by the CIPFA Accounting and Financial Reporting Forum to include:

   - a new unusable reserve established to hold the fair value movements on pooled investment funds
   - the Dedicated Schools Grant Adjustment Account unusable reserve
   - changes to the Code for the Telling the Story review introduced in the 2016/17 year
   - a number of other more minor augmentations.

3. The "New Reporting Framework" described in LAAP Bulletin 55 has now largely been overtaken by statutory requirements but is included in Appendix A for information.

4. Relevant extracts from the IFRS–based Code are provided at Appendix B.

5. LASAAC has issued mandatory guidance [The Statutory Basis for Accounting for and Disclosing Reserves in Scottish Local Government Bodies] (Revised 2021) where there are particular differences including on the reporting of the earmarked portion of reserves and deferred capital receipts. Scottish local authorities should ensure that they follow this guidance and refer to it directly.

Purpose

6. This bulletin provides guidance to local authority chief finance officers in England, Northern Ireland, Scotland and Wales on the establishment and maintenance of local authority reserves and balances.

Application

7. In England, Scotland and Wales the guidance is applicable to local authorities, joint committees and joint boards of principal authorities, though local authorities in Scotland must ensure that they follow the LASAAC mandatory guidance referred to in paragraph 5 above.

8. In England and Wales, the guidance is applicable to Police and Crime Commissioners, Chief Constables and fire and rescue authorities.

9. In Northern Ireland the guidance applies to all district councils.

10. The general principles set out in this guidance apply to an authority's General Fund, Council Fund, Police Fund and, where appropriate, to the Housing Revenue Account (HRA).

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[1] Code of Practice on Local Authority Accounting in the United Kingdom – updated annually.

11. The advice in this bulletin relates to reserves, not provisions. The Code definitions of provisions and reserves are included in Appendix B to this bulletin for information.

12. This bulletin replaces LAAP Bulletin 99.

Legislative/regulatory framework

13. The requirement for financial reserves is acknowledged in statute. Sections 31A, 32, 42A 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 for meeting estimated future expenditure when calculating the budget requirement. Section 93 of the 1992 Act requires Scottish authorities, in calculating council tax, to take into account "any means by which those expenses may otherwise be met or provided for". This includes reserves.

14. In Scotland there are explicit statutory powers under schedule 3 of the Local Government (Scotland) Act 1975 permitting certain local authorities to establish a renewal and repair fund, an insurance fund and a capital fund alongside a requirement, as in England and Wales, to maintain a General Fund (Section 93 of Part VII of the Local Government (Scotland) Act 1973). LASAAC has published guidance on reserves which is available from the LASAAC website. In Northern Ireland, Section 9 of the Local Government Finance Act (Northern Ireland) 2011 enables councils to maintain other funds in addition to the General Fund. Local authorities may however 'earmark' specific parts of the General Fund reserve. This earmarking of a proportion of the General Fund is referred to in this Bulletin as Earmarked Reserves.

15. There are also a range of safeguards in place that help to prevent local authorities over-committing themselves financially. These include:

- the balanced budget (or in England calculation of council tax) requirement:
  - England, Sections 31A, 42A of the Local Government Finance Act 1992, as amended
  - Wales, Sections 32 and 43 of the 1992 Act
  - Scotland, Section 93 of the Local Government Finance Act 1992
  - Section 85 of the Greater London Authority Act 1999
- chief finance officers' duty to report on robustness of estimates and adequacy of reserves (under Section 25 of the Local Government Act 2003) when the authority is considering its budget requirement (England and Wales); Section 28 of the Act also requires budget monitoring 'from time to time' and take action to deal with any deterioration
- chief finance officers' duty to report on the robustness of estimates and the adequacy of reserves (under Sections 4 and 6 of the Local Government and Finance Act (Northern Ireland) 2011)
- the legislative requirement for each local authority to make arrangements for the proper administration of their financial affairs and that the chief finance officer/proper officer has responsibility for the administration of those affairs, Section 151 of the Local Government Act 1972, Section 95 of the Local Government (Scotland) Act 1973 and Section 1 of the Local Government and Finance Act (Northern Ireland) 2011
- the requirements of the Prudential Code.

16. These requirements are reinforced by Section 114 of the Local Government Finance Act 1988 which requires the chief finance officer in England and Wales 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. The issue of a Section 114 notice

cannot be taken lightly and has serious operational implications. Indeed, the authority's full council must meet within 21 days to consider the s114 notice and during that period the authority is prohibited from entering into new agreements involving the incurring of expenditure.

17. While it is primarily the responsibility of the local authority and its chief finance officer to maintain a sound financial position, external auditors will confirm that there are no material uncertainties about going concern (though see the Code's commentary at paragraph 3.8.2.14 on going concern basis of reporting). It is not an auditor's responsibility to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general.

18. CIPFA's Prudential Code requires chief finance officers in local authorities to have full regard to affordability when making recommendations about the local authority's future capital programme. Such consideration includes the level of long-term revenue commitments. Indeed, in considering the affordability of its capital plans, the authority is required to consider all the resources available to it estimated for the future, together with the totality of its capital plans and revenue forecasts for the forthcoming year and the following two years.

19. The CIPFA Financial Management Code (a professional Code for CIPFA members) Financial Management Standard K also specifies that:

The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves.

Role of the chief finance officer (proper officer in Scotland)

20. Within the existing statutory and regulatory framework, it is the responsibility of chief finance officers (proper officer in Scotland) to advise local authorities about the level of reserves that they should hold and to ensure that there are clear protocols for their establishment and use. Reserves should not be raised without a clear purpose.

21. CIPFA considers that local authorities should establish reserves and determine the level of those reserves based on the advice of their chief finance officers. Authorities should make their own judgements on such matters taking into account all the relevant local circumstances. Such circumstances vary. A well-managed authority, for example, with a prudent approach to budgeting should be able to operate with a level of general reserves appropriate for the risks (both internal and external) to which it is exposed. In assessing the appropriate level of reserves, a well-managed authority will ensure that the reserves are not only adequate but are also necessary. There is a broad range within which authorities might reasonably operate depending on their circumstances.

22. Section 26 of the Local Government Act 2003 gives Ministers in England and Wales 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. This accords with CIPFA's view that a generally applicable minimum level is inappropriate, as a minimum level of reserve will only be imposed where an authority is not following best financial practice (including the guidance in this bulletin).

Types of reserve

23. For statutory purposes, there is a single revenue reserve, the General Fund Balance. When reviewing their medium-term financial plans and preparing their annual budgets local authorities should consider the establishment of sub reserves (known as earmarked reserves) within the General Fund Balance and maintenance of general reserves. These can be held for three main purposes:

- a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – 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 (or earmarked portion of the General Fund in Scotland – see also LASAAC Guidance on Reserves referred to in paragraph 5), to meet known or predicted requirements. Earmarked reserves may be reported separately but remain legally part of the General Fund. Separate reporting of earmarked reserves has no financial reporting or legislative necessity though they are used extensively by local authorities and as such the Code requires separate disclosure of material earmarked reserves. As the statutory reserve is the General Fund Balance, it is possible within this balance for earmarked reserves to have debit balances. For example, where a reserve held for a specific service activity may have overspent and an authority requires that this balance is made good from next year's budget with such balances offsetting against general reserves in the calculation of the overall General Fund Balance.

Principles to assess the adequacy of reserves

24. In order to assess the adequacy of unallocated general reserves when setting the budget, chief finance officers should take account of the strategic, operational and financial risks facing the authority.

25. This Bulletin of necessity prioritises the statutory duties of the chief finance officers in assessing adequacy of reserves and other statutory roles in budget setting. However, the CIPFA Financial Management Code also highlights the role of the leadership of the authority. It sets out that it is for the leadership team to ensure that the authority's governance arrangements and style of financial management promote financial sustainability.

26. Where authorities are being reorganised, this assessment should be conducted on the basis that the services will continue to be provided, and adequate reserves will therefore be required by successor authorities. The assessment of risks should include external risks, such as flooding, as well as internal risks, for example, the ability to deliver planned efficiency savings. Statutory provisions require authorities to review at least once in a year the effectiveness of their system of internal control, which will include risk management. The CIPFA/SOLACE framework Delivering Good Governance in Local Government details an approach to giving assurance that risk, control and governance matters are being addressed in accordance with best practice.

27. The Codes of Audit Practice in England, Wales, Scotland and Northern Ireland make it clear that it is the responsibility of the audited body to identify and address its operational and financial risks, and to develop and implement proper arrangements to manage them, including adequate and effective systems of internal control. The financial risks should be assessed in the context of the authority's overall approach to risk management.

Table 1: 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.

Budget assumptions	Financial position and management assessment of impact
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.

28. While many of these factors relate to setting the annual budget, the level of risk and uncertainty associated with these factors will be relevant in determining an appropriate level of reserves.

29. Authorities have been faced by increasing financial pressures and a period of severely constrained resources since 2008. Demands on local government services continue to increase. Local authorities now face significant resource pressures because of increased and increasing inflation and the cost-of-living challenges. In addition to, these challenges other pressures include:

- councils striving to constrain council tax increases
- reductions of income
- new service demands and responsibilities such as:
  - demographic changes such as the rise in the elderly population
  - accommodating refugees
  - the localisation of non-domestic rates retention, council tax freezes and council tax benefits/support
- severe weather, floods and other consequences of climate change.

30. Furthermore, events in global financial markets, the memory of issues such as the losses in Icelandic banks and the recent COVID-19 pandemic are likely to mean that councils will focus on cautious investment strategies. Council budgets and reserves have remained under pressure and are likely to continue to do so for some time.

31. The many factors involved when considering appropriate levels of reserves can only be assessed properly at a local level. A considerable degree of professional judgement is required. The chief finance officer may choose to express advice on the level of balances in cash and/or as a percentage of budget (to aid understanding) so long as that advice is tailored to the

circumstances of the authority. The NAO in its report noted that local authority reserves represent the most fundamental buffer when uncertainty rises so it is not surprising that local authority reserves increase when uncertainty increases though the report also acknowledges that adding to reserves competes with service needs (*The local government finance system in England: overview and challenges*, NAO, November 2021). Similarly, the Chair of the Accounts Commission in his opening remarks to the report Local Government in Scotland Financial Overview 2020/21 said "*That all councils have increased their reserves, boosted by late funding from the Scottish Government to help mitigate the impacts of COVID --19, distracts from the underlying pressures and continued uncertainty on council finances."* The report also commented that managing reserves and medium and longer-term financial planning will continue to be key to maintaining financial sustainability (Accounts Commission. March 2022). The principles and financial reporting established in this CIPFA Bulletin and the previous LAAP bulletins on reserves will provide for the information requirements and an appropriate framework for this.

32. The advice should be set in the context of the authority's risk register and medium-term plans and should not focus exclusively on short-term considerations. Balancing the annual budget by drawing on general reserves may be viewed as a legitimate short-term option. However, it is not normally prudent for reserves to be deployed to finance recurrent expenditure. CIPFA has commented that councils should be particularly wary about using reserves to deal with shortfalls in current funding. Where such action is to be taken, this should be made explicit, and an explanation given as to how such expenditure will be funded in the medium to long term. Advice should be given on the adequacy of reserves over the lifetime of the medium-term financial plan and should also take account of the expected need for reserves in the longer term.

33. Events such as the floods and severe weather episodes, the COVID-19 pandemic and the current cost of living crisis have emphasised the need for authorities to be prepared for major unforeseen events. Adequate insurance cover combined with appropriate levels of reserves will enable authorities to manage the demands placed on them in such circumstances. However, these arrangements need to take account of all possible scenarios.

34. Part of the risk management process involves taking appropriate action to mitigate or remove risks, where this is possible. This in turn may lead to a lower level of reserves being required, and it would be appropriate to consider reducing the level of balances held where appropriate action to mitigate or remove risks has been successfully undertaken. A balance will need to be found between maintaining adequate levels of reserves and investing in risk reduction measures. This balance should form part of the risk management process and be considered as part of the annual budget process.

35. Emergency financial assistance from central government may be available to assist authorities in dealing with the immediate consequences of major unforeseen events, normally under the Emergency Financial Assistance to Local Authorities scheme (commonly known as the 'Bellwin' scheme). However, there is no automatic entitlement to financial assistance, and where financial assistance is given, it will not cover all the costs even in exceptional circumstances. Further details of the scheme are available on the relevant government websites. Authorities should plan to have access to sufficient resources (through reserves, insurance, or a combination of both) to cover the costs of recovering from events that are likely to be unavoidable.

36. When considering the level of reserves, it would be appropriate for authorities to take into account the likely level of government support that would be available, and to consider how the balance would be funded in the event of an unforeseen event occurring.

37. Flooding, the effects of severe weather, the impact of the problems experienced in the global financial markets, the possibility of future pandemics and the cost-of-living crisis are examples of external risks which local authorities may need to take into account in setting levels of reserves and wider financial planning. An assessment of external risks should not be limited to those

issues, but should range more widely, to take account of all significant external risks identified through the authority's risk management processes.

Types of earmarked reserve

38. When considering the level of reserves, it is appropriate to consider the different types of earmarked reserves held by the authority. Table 2 below presents typical reserves held by local authorities and the rationale for holding them though this listing is not intended to be an exhaustive list. Local authorities will need to ensure that there are processes which keep the rationale for holding the reserves and the amount of the reserves held under review, remain consistent with their purposes and their approach to risk management.

Table 2: Typical reserves held by local authorities and the rationale for holding them

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 accounting periods, it is prudent to set aside resources in advance.
Insurance reserves (note that the Insurance Fund is a statutory fund in Scotland)	Self–insurance is a mechanism used by a number of local authorities. In the absence of any statutory basis (other than in Scotland) sums held to meet potential and contingent liabilities are reported as earmarked reserves where these liabilities do not meet the definition of a provision under the requirements of the Code's adoption of IAS 37 *Provisions, Contingent Assets and Liabilities*).
Reserves of **trading and business units**	Surpluses arising from in-house trading may be retained to cover potential losses in future years, or to finance capital expenditure.
Reserves retained for **service departmental use**	Authorities may have internal protocols that permit year-end under-spendings at departmental level to be carried forward. Although not recommended any deficits on such reserves would normally be offset against the General Fund Balance and made good against the following year's service budget.
Reserves established to manage **corporate priorities**	It may be necessary to set up earmarked reserves to manage specific across departmental priorities including transformation, responses to cross departmental policy issues, authority infrastructure etc.

Type of earmarked reserve	Rationale
Reserves for **unspent revenue grants**	Where revenue grants have no conditions or where the conditions are met, and expenditure has yet to take place. The Code Guidance Notes recommend that these sums are held in earmarked reserves (see paragraph 44 below).
Schools' balances	These are unspent balances of budgets delegated to individual schools (but please see separate section on **Dedicated Schools Grant adjustment account)**.
General contingencies to manage risk	Although various reserves are established to manage individual risks – CFOs 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.

Financial reporting for reserves

39. The IFRS-based Code of Practice on Local Authority Accounting in the United Kingdom (the Code) introduced the Movement in Reserves Statement to local authority financial statements in the 2010/11 financial year. This Statement presents the movement in the year of the reserves of the authority analysed into usable reserves, (eg General Fund, HRA Balances) and unusable reserves (see paragraph 40 for more detail).

40. Unusable reserves arise out of the interaction of legislation and proper accounting practice either to store revaluation gains or as adjustment accounts to reconcile accounting requirements driven by reporting standards to statutory requirements. These reserves[2], which are not resource-backed and cannot be used for any other purpose, are described below:

Revaluation reserves

- The **revaluation reserve** – this is a reserve that records unrealised gains in the value of property, plant and equipment. The reserve increases when assets are revalued upwards and decreases as assets are depreciated or when assets are revalued downwards or disposed of. Local authorities might benefit from these gains in the future from the continued use of the assets or from their sale. The reserve contains only revaluation gains accumulated since 1 April 2007, the date that the reserve was created. Accumulated gains arising before that date are consolidated into the balance

[2] In addition to the reserves included in this list authorities may hold the deferred capital receipts reserve and the accumulated absences account. Further details on these reserves are included in the *Code of Practice on Local Authority Accounting in the United Kingdom: Guidance Notes for Practitioners* for the relevant year accounts.

on the capital adjustment account.

- The **financial instruments revaluation reserve** – this reserve will be used in limited circumstances (for example, where an authority might decide to designate an equity instrument to fair value through other comprehensive income).

Adjustment accounts

- The **pensions reserve** – this is a specific accounting mechanism used to reconcile the payments made for the year to various statutory pension schemes in accordance with those schemes' requirements and the net change in the authority's recognised liability under the Code's adoption of IAS 19 *Employee Benefits*, for the same period. A transfer is made to or from the pensions reserve to ensure that the charge to the General Fund reflects the amount required to be raised in taxation. For example, the debit balance on the reserve shows that an authority has made commitments to fund pensions that the government has permitted it to fund from contributions to be made in future years.

- The **capital adjustment account** – this is a specific accounting mechanism used to reconcile the different rates at which assets are depreciated under proper accounting practice and are financed through the capital controls system. Statute requires that the charge to the General Fund is determined by the capital controls system. For example, the credit balance on the account shows that an authority has generally financed capital investment in advance of receiving the benefits of that investment. The account also contains revaluation gains[3] accumulated on property, plant and equipment before 1 April 2007, the date that the revaluation reserve was created to hold such gains.

- The **financial instruments adjustment account** – this is a specific accounting mechanism used to reconcile the different rates at which gains and losses (such as premiums on the early repayment of debt) are recognised under proper accounting practice and are required by statute to be met from the General Fund. For example, the debit balance on the account shows that an authority has incurred expenses on borrowings that the government has permitted it to spread over future years.

- The **unequal pay back pay account** – this is a specific accounting mechanism used to reconcile the different rates at which payments in relation to compensation for previous unequal pay are recognised under proper accounting practice and are required by statute to be met from the General Fund.

- The **collection fund adjustment account** – this is a specific accounting mechanism used to reconcile the differences arising from the recognition of council tax and non-domestic rates income (England) in the Comprehensive Income and Expenditure Statement to those amounts required to be charged by statute to the General Fund. For example, the credit balance on the account shows that more tax has been collected on behalf of the authority and the precepting bodies (and central government in England for non-domestic rates income) than an authority is permitted to transfer out of the Collection Fund by 31 March. This account is not applicable to Scotland.

- The **pooled investment funds adjustment account (England and Wales)** – this reserve is a mechanism which is required by the capital finance and accounting regulations in England and Wales to hold the fair value movements in those pooled investment funds specified by the regulations. The difference between the amount charged or credited in the year to surplus or deficit on the provision of services in accordance with the Code and the amount charged or credited to the General Fund in

[3] Paragraph 4.1.2.48 of the Code allows Scottish authorities to transfer the difference between depreciation based on the revalued carrying amount of the asset and the depreciation based on the asset's historical cost directly to the General Fund. So, for Scottish authorities only the remaining historical cost element of depreciation in the General Fund that is subject to transfer to the capital adjustment account.

accordance with regulations should be debited or credited to the General Fund balance with the double entry going to the pooled investment funds adjustment account such that the General Fund is charged or credited with the amount that accords with the applicable regulations.

- The **Dedicated Schools Grant adjustment account** – the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2020 established that where a local authority has a deficit on its schools budget, the authority must not charge any such deficit to its revenue account (including cumulative deficits incurred before the regulations were established). Instead, the regulations provide that a local authority must charge any such deficit to a separate account, established and usable solely for that purpose. Note that even though an account has been set up to hold these deficits the financial impact of these deficits should be clearly reported in the financial statements and proper account taken of the impact of these deficits in any budgetary statements or reports on the adequacy of reserves.

41. Other such reserves may be created in future where developments in local authority accounting result in timing differences between the recognition of income and expenditure under proper accounting practice and under statute or regulation. Note also these reserves may be removed where the regulations that have required them to be established end or they may be time limited.

42. In addition, authorities will hold the following three usable reserves:

- a **Major Repairs Reserve (England and Wales)**, where relevant – in England this reserve records the unspent amount of HRA balances for capital financing purposes in accordance with statutory requirements for the reserve. In Wales this represents the amounts unspent from the Major Repairs Allowance capital grant.

- a **capital receipts reserve (Capital Fund in Scotland[4])** – this reserve holds the proceeds from the sale of assets and can only be used for those purposes specified in the capital finance and accounting regulations[5] in England, Northern Ireland and Wales and for capital purposes in Scotland.

- a **capital grants unapplied account[6]** – (note though this is described as an account paragraph 3.4.2.58 lists this as a reserve) this reserve will hold capital resources (from capital grants) that have been recognised as income and not yet applied to capital expenditure.

43. When establishing reserves, local authorities need to ensure that they are complying with the Code and in particular the need to distinguish between reserves and provisions. Definitions of reserves and provisions are included in Appendix B of this Bulletin.

44. The introduction of the IFRS-based Code on 1 April 2010 has meant that grant income should be recognised in the Comprehensive Income and Expenditure Statement (and therefore against the General (Council) Fund or HRA Balances for revenue grants) where grant payment is

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[4] The Statutory Basis for Accounting and Disclosing Reserves in Local Authorities in Scotland [LASAAC, Revised 2021] states “Paragraph 22(1a) of Schedule 3 of the Local Government (Scotland) Act 1975 (1975 Act) empowers (but does not require) a local authority to establish a Capital Fund.” The LASAAC Guidance indicates that proceeds from the disposal of an asset (ie capital receipts) are a permitted credit to that fund (unless set aside to fund equal pay, transformation projects or premiums arising from the refinancing of debt).

[5] The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, as amended and the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011.

[6] Capital grant and receipts unapplied account in Scotland.

unconditional or grant conditions have been satisfied[7]. The Code Guidance Notes recommend[8] that where these grants have been received prior to the expenditure having taken place authorities should consider establishing earmarked reserves. This will ensure that amounts are set aside from the General (or Council) Fund and HRA balances in earmarked reserves to provide financing to meet the requirements of the grant. The amounts set aside will be posted back from earmarked reserves to meet General Fund and HRA expenditure in future years. It is likely therefore that since the introduction of the IFRS-based Code there is an increased tendency to hold earmarked reserves.

45. The statutory reporting regime described earlier, and effective financial management underpin the need for clear, transparent reporting arrangements for reserves and therefore in addition to the financial reporting requirements above, the Accounting and Financial Reporting Forum recommends that for each earmarked reserve (earmarked portion of the General Fund in Scotland) held by a local authority there should be a clear protocol setting out:

- the reason for/purpose of the reserve
- how and when the reserve can be used
- procedures for the reserve's management and control, and
- a process and timescale for review of the reserve to ensure continuing relevance and adequacy.

[7] See Code of Practice on Local Authority Accounting in the United Kingdom, Section 2.3.
[8] See Code of Practice on Local Authority Accounting in the United Kingdom: Guidance Notes for Practitioners 2022/23 Accounts, paragraphs C38 to C40.

Appendix A

Extract from LAAP Bulletin 55

7 A New Reporting Framework

7.1 The finance director [chief finance officer] 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.

7.2 The level and utilisation of reserves will be determined formally by the council, informed by the advice and judgement of the finance director[9]. To enable the council to reach its decision, the finance director should report the factors that influenced his or her judgement and ensure that the advice given is recorded formally. Where the finance director's advice is not accepted this should be recorded formally in the minutes of the council meeting.

7.3 It is recommended that:

- the budget report to the council should include a statement showing the estimated opening general reserve fund balance for the year ahead, the addition to/withdrawal from balances, and the estimated end of year balance. Reference should be made as to the extent to which such reserves are to be used to finance recurrent expenditure

- this should be accompanied by a statement from the finance director on the adequacy of the general reserves and provisions in respect of the forthcoming financial year and the authority's medium term financial strategy

- a statement reporting on the annual review of earmarked reserves (including schools' reserves) should also be made at the same time to the council. The review itself should be undertaken as part of the budget preparation process. The statement should list the various earmarked reserves, the purposes for which they are held and provide advice on the appropriate levels. It should also show the estimated opening balances for the year, planned additions/withdrawals and the estimated closing balances.

[9] CIPFA Bulletin 13 Updated normally refers to chief finance officers consistent with the legislative duties on reserves – previous editions of this Bulletin referred to finance directors.

Appendix B

Definitions of reserves and provisions extracted from the 2022/23 Code of Practice on Local Authority Accounting in the United Kingdom

Definition of reserves

2.1.2.36 **Reserves**[10] represent the residual interest in the assets of the authority after deducting all its liabilities. The Movement in Reserves Statement shows the true economic cost of providing the authority's services. Some income and expenditure is required to be recognised on a different basis or in a different accounting period (ie in accordance with legislation) in the General Fund and Housing Revenue Account. These differences are shown in the line 'Adjustments between accounting basis and funding basis under regulations'. The Movement in Reserves Statement shows total comprehensive income and expenditure and the Comprehensive Income and Expenditure Statement shows the breakdown between the surplus or deficit on the provision of services and other comprehensive income and expenditure.

Classification of reserves in the Movement in Reserves Statement

3.4.2.58 **The classification of reserves presented in the Movement in Reserves Statement shall include the following items; authorities may choose to present additional items on the face of the statement:**

a) General Fund balance
b) Housing Revenue Account balance
c) major repairs reserve (England and Wales)
d) revenue statutory funds (Scotland)
e) capital receipts reserve (England and Wales); capital statutory funds (Scotland)
f) capital grants unapplied account (or capital grants and receipts unapplied account in Scotland)
g) total usable reserves
h) unusable reserves
i) total reserves of the authority
j) authority's share of the reserves of subsidiaries, associates and joint ventures (group accounts only)
k) total reserves (group accounts only).

Definition of a provision

8.2.2.9 **A provision is a liability of uncertain timing or amount.**

Provisions – recognition and measurement

8.2.2.12 **A provision shall be recognised when:**

- an authority has a present obligation (legal or constructive) as a result of a past event
- it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, and
- a reliable estimate can be made of the amount of the obligation.

[10] The term 'reserves' is used in the Code and replaces many references to 'equity' residual interest in IFRS and other IASB pronouncements. This reflects the fact that most accounts prepared under the Code will not be for investor-owned companies. Some references to 'equity' are retained where appropriate.

8.2.2.13 If the above conditions are not met, no provision shall be recognised.