Agenda Item No:

Report to: **Charity Committee**

Date of Meeting: **2 July 2012**

Report Title: **Foreshore Trust - Financial Report**

Report By: **Head of Finance**

Purpose of Report

To advise members of the Committee on the financial position for 2011/12, the current year's financial position (2012/13) and review the Reserves Policy.

Recommendations

1. **The financial position for 2011/12 and 2012/13 be noted and agreed**
2. **The reserves policy be retained and be subject to regular review.**

Reasons for Recommendations

The Council has the responsibility for the proper management of the financial affairs of the Trust. The use of any potential surpluses generated by the Trust must be determined in the light of affordability.

The level of Reserves to be maintained is dependent on the current and future plans of the Trust and also the potential financial risks that the Trust could face in the years to come.

Given this still remains early days for the Council's financial management of the Trust the retention of a prudent level of reserves is recommended.

Introduction

1. The Foreshore Trust derives its income mainly from car parking and property leases/licences. Legal fees continue to be incurred in determining Trust boundaries and the respective liabilities of the Council and the Trust and further limited costs are expected in 2012/13 as boundary lines are finalised with the land registry.

Financial Position 2011/12

2. The closing of the Council's accounts at the time of writing has yet to be completed and will then be audited. The estimate at this stage for the Trust is a surplus in 2011/12 of some £196,275 before grants and before use of reserves. This figure remains an estimate until the account closure processes are fully completed.

3. Appendix 1 attached provides a summarised financial position for 2010/11(for comparative purposes), the 2011/12 position – including budget and revised budget, and a budget position for 2012/13.

Financial Position 2012/13

4. The budget was agreed at the last Committee meeting. In brief, income was budgeted at £1,037,260 and expenditure at £862,800. The estimated surplus for the year being £174,460 (before grants and use of reserves).

7. The 2012/13 budget attached now includes the costs for Accountants (Manningtons) following the tender exercise for Final Accounts production and audit fees.

Reserves

8. The total balances on the Trust accounts at the 31 March 2011 amounted to £1,991,758 of which £1,790,714 was effectively held in cash. With an estimated surplus of £196,275 in 2011/12 the estimated balance at 31 March 2012 is £2,026,175 of which some £1,803,616 is held in cash.

9. **Reserves Policy**

Appendix 2 attached provides background information on determining a Reserves policy. This is based on extracts of the Charity Commission guidance on this issue.

Appendix 3 seeks to identify the potential risks to the Foreshore Trust that could have financial implications, and which necessitate the maintenance of reserves.

Appendix 4 attached contains the Reserve policy.

Key points about charity reserves :-

1. Charity law requires any income received by a charity to be spent within a reasonable period of receipt.
2. Trustees should be able to justify the holding of income as reserves.
3. Reserves are that part of a charity's unrestricted income funds that is freely available to spend.

4. Where the trustees have a reserves policy, this policy must be set out in the trustees' annual report.

5. If the trustees have not set a reserves policy, this should be stated in the trustees' annual report.

6. A good reserves policy takes into account the charity's financial circumstances and other relevant factors.

7. It is good practice to monitor the level of reserves held throughout the year.

8. It is good practice to keep the reserves policy under review to ensure it meets a charity's changing needs and circumstances.

10. In summary the Reserves policy (Appendix 4) effectively recommends that Cash Reserves of £680,000 be retained, plus sufficient funds to meet the Repairs and Renewals programme which as it is in its infancy remains subject to regular amendment. It is also recommended that the Reserves policy continue to be regularly reviewed.

Use of Surpluses

11. The Trust has a duty to maintain its assets and only thereafter to consider the use of any surpluses for the benefits of the community.

12. The Committee agreed at its last meeting to make available £50,000 for grants in 2012/13 in the light of estimates indicating the Trust will continue to generate a surplus and to provide some certainty for organisations bidding for grants. The total level of grants given in any one year is based on the level being set at 25% of any surplus actually achieved, albeit the Committee can review the figure at any stage.

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

Area(s) Affected

Central Hastings, East Hastings, North St. Leonards, South St. Leonards

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No

Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No

Background Information

Charity Commission guidance (Charities and Reserves (CC19), June 2010).

Officer to Contact

Peter Grace, Head of Finance
pgrace@hastings.gov.uk
01424 451503

NOTE

Appendix 1 could not be published on the Council's website. A copy may be obtained from Elaine Wood, Principal Committee Administrator, email ewood@hastings.gov.uk or tel 01424 451717.

APPENDIX 2

Reserves Policy

1. Introduction

In determining the policy in Appendix 4 of this report due recognition has been taken of the Charity Commission guidance on this area (Charities and Reserves (CC19), June 2010). This guidance is written for trustees of all types of charities, whether they are companies, trusts or associations. It explains what is meant by the term reserves, the trustees' responsibility to consider whether their charity needs reserves, and what to bear in mind when developing a policy on reserves.

2. Common Terminology

To understand the rules surrounding the establishment and use of reserves there is a need to understand the terminology used in accounting for charities.

Designated funds are part of the unrestricted funds which trustees have earmarked for a particular project or use, without restricting or committing the funds legally. The designation may be cancelled by the trustees if they later decide that the charity should not proceed or continue with the use or project for which the funds were designated.

Income and income funds means all incoming resources that become available to a charity and that the trustees are legally required to spend in furtherance of its charitable purposes within a reasonable time of receipt. Income funds may be unrestricted or restricted to a particular purpose of the charity.

Programme related or social investment is not 'investment' in the conventional sense of a financial investment. Conventional investments involve the acquisition of an asset with the sole aim of financial return which will be applied to the charity's objects. Programme related or social investments, by contrast, are made directly in pursuit of the organisation's charitable purposes. Although they can generate some financial return, the primary motivation for making them is not financial but the actual furtherance of the charity's objects.

Restricted funds: Restricted funds are funds subject to specific trusts, which may be declared by the donor(s) or with their authority (eg in a public appeal) or created through legal process, but still within the wider objects of the charity. Restricted funds may be restricted income funds, which are spent at the discretion of the trustees in furtherance of some particular aspect(s) of the objects of the charity, or they may be endowment funds, where the assets are required to be invested, or retained for actual use, rather than spent.

Risk is used in this guidance to describe the uncertainty surrounding events and their outcomes that may have a significant financial impact. Risk may either enhance or inhibit any area of a charity's operations.

Unrestricted funds (including designated funds): Unrestricted income funds are income or income funds which can be spent at the discretion of the trustees in furtherance of any of the charity's objects. If part of an unrestricted income fund is earmarked for a particular project it may be designated as a separate fund, but the designation has an administrative purpose only, and does not legally restrict the trustees' discretion to spend the fund.

3. Understanding reserves and the need for a reserves policy

What are reserves?

Reserves are that part of a charity's unrestricted funds that is freely available to spend on any of the charity's purposes. This definition excludes restricted income funds and endowment funds, although holding such funds may influence a charity's reserves policy. Reserves will also normally exclude tangible fixed assets held for the charity's use and amounts designated for essential future spending.

The Charities SORP defines reserves as that part of a charity's income funds that is freely available to spend. Reserves therefore exclude endowment or restricted income funds which have particular restrictions on how the funds may be used. Trustees need to consider how the funds of the charity are held and how they are being used in order to identify those resources that are freely available to spend.

Unrestricted funds

The starting point for calculating the amount of reserves held will normally be the amount of unrestricted funds held by a charity. However, part of the unrestricted funds of a charity may not always be readily available for spending. Examples of this are:

- Tangible fixed assets: the Charities SORP specifically allows funds held as tangible fixed assets for charity use to be excluded from reserves. This recognises that certain assets will be used operationally and their disposal may adversely impact on a charity's ability to deliver its aims.

- Programme-related investments: where a charity makes programme- related investments solely to further its charitable purposes, then such investments can be excluded from reserves.

- Designated funds: where unrestricted funds are earmarked or designated for essential future spending, for example, to fund a project that could not be met from future income alone they can be excluded from reserves. In such cases the reserves policy should explain the nature and amount of the designation and when the funds set aside are likely to be spent. It is never acceptable to set up designations simply to reduce the stated level of reserves.

Why is a reserves policy important?

Deciding the level of reserves that a charity needs to hold is an important part of financial management and forward financial planning. Reserves levels which are higher than necessary may tie up money unnecessarily. Holding excessive reserves can unnecessarily limit the amount spent on charitable activities, reducing the potential benefits a charity can provide. However, if reserves are too low then the charity's solvency and its future activities can be put at risk.

All charities need to develop a policy on reserves which establishes a level of reserves that is right for the charity and clearly explains to its stakeholders why holding these reserves is necessary.

A good reserves policy will explain how reserves are used to manage uncertainty and, if reserves are held to fund future purchases or activities, it will explain how and when the reserves will be spent. A reserves policy provides assurance that the finances of the charity are actively managed and its activities are sustainable. In particular, a reserves policy can help to:

- give confidence to funders by demonstrating good stewardship and financial management;

- demonstrate the charity's sustainability and capacity to manage unforeseen financial difficulties;

- give voluntary funders, such as grant-makers, an understanding of why funding is needed to undertake a particular project or activity;

- give assurance to lenders and creditors that the charity can meet its financial commitments; and

- manage the risk to a charity's reputation from holding substantial unspent funds at the year-end without explanation.

Developing a reserves policy is also an important part of the internal financial management of a charity. Developing a reserves policy is likely to:

- Assist in strategic planning, for example, considering how new projects or activities will be funded.

- Inform the budget process, for example, is it a balanced budget or do reserves need to be drawn down or built up?

- Inform the budget and risk management process by identifying any uncertainty in future income streams.

The reserves policy will develop in an integrated manner, recognising that strategic and financial planning informs the development of reserves policies and vice versa. For example, the budgets will identify peaks and troughs in cash flow and the reserves policy will need to ensure the troughs in funding can be met from reserves held.

How should a reserves policy be developed?

Trustees need to understand the nature of any restrictions on the use of the charity's funds they hold. Budgets and future plans need to be considered, in particular any uncertainty over future income or the risk of unexpected calls on the charity's funds. In looking at future plans, projects or other spending needs might be identified that cannot be met from the income of a single year's budget alone. Having identified why reserves might be needed, trustees then need to think about how much might be required and how much is currently held as reserves. The decision made on these matters and the quantification of the amounts that need to be set aside forms a charity's reserves policy.

In more detail

There is no single method or approach to setting a reserves policy. The approach adopted will vary with the size, the nature and complexity of activities and the nature of funds received and held by a charity. However, for all charities, setting a reserves policy will involve:

- Consideration of the nature of the funds received and held by the charity - are the funds unrestricted or restricted income, or expendable or permanent endowment? This understanding allows trustees to identify unrestricted funds which can be spent on any purposes of the charity.

- Larger charities are likely to have a formal risk management process. But all charities need to think about uncertainties they may face in the future and the need to hold some reserves to meet an unexpected call on funds or opportunities that may present themselves.

- Larger charities are likely to have strategic and operational plans. But all charities need to think about their future budgets and future projects or spending plans that cannot be met from the income of a single year.

By working through these steps the trustees will be well placed to identify why reserves might need to be held and to quantify the amounts of reserves needed to operate effectively.

Once a reserves policy is set, it should not be regarded as a static policy. The circumstances of a charity will change with time and we recommend that the policy should be reviewed at least annually as part of a charity's planning processes. The amount held in reserves should also be monitored during the course of the year as part of a charity's budgetary processes.

What level or range of reserves is required?

The charity's target level of reserves can be expressed as a target figure or a target range and should be informed by:

- its forecasts for levels of income for the current and future years, taking into account the reliability of each source of income and the prospects for developing new income sources;

- its forecasts for expenditure for the current and future years on the basis of planned activity;

- its analysis of any future needs, opportunities, commitments or risks, where future income alone is unlikely to be able to meet anticipated costs; and

- its assessment, on the best evidence reasonably available, of the likelihood of each of those needs that justify having reserves arising and the potential consequences for the charity of not being able to meet them.

Trustees who hold reserves without attempting to relate their need for reserves to factors such as these will have difficulty in satisfactorily explaining why they hold the amount of reserves that they do.

What steps should trustees take to maintain and monitor reserves at the target level?

Having set the reserves level or range in which it is desirable to operate, it is important to monitor the reserves actually held to establish the reason for any significant difference with the target level set. If reserves during the year are below target or exceed target, the trustees should consider whether this is due to a short-term situation or a longer-term issue. Action may be needed to replenish or spend reserves.

The trustees' monitoring of reserves should not just be a year-end procedure. How the level of reserves changes during the year can be a good indicator of the underlying financial health of the charity and can be an indicator of potential problems. The level of reserves should be monitored throughout the year as part of the normal monitoring and budgetary reporting processes.

In particular, trustees should:

- identify when reserves are drawn on so that they understand the reasons and can consider the corrective action, if any, that needs to be taken;

- identify when reserve levels rise significantly above target so that they understand the reasons and can consider the corrective action, if any, that needs to be taken;

- identify where the reserves level is below target, consider whether this is due to short-term circumstance or longer term reasons which might trigger a broader review of finances and reserves;

- regard the ongoing review of the reserves level, target and policy as part of managing the charity;

- ensure that the reserves policy continues to be relevant as the charity develops or changes its strategy and activities;

- review the statement on reserves in the trustees' annual report where there have been significant changes in the reserves policy or level of reserves held.

Explaining reserves in the annual report

The Charities SORP requires trustees to include in their annual report:

- a statement of their policy on reserves;
- the level of reserves held and an explanation of why they are held;
- where material funds have been designated, the amount and the purpose of the designation should be explained;
- where designated funds are set aside for future expenditure, the likely timing of that expenditure.

Why might you need reserves for the charity to be effective?

The basis of a good reserves policy is thinking through exactly why you might need to hold back some funds as reserves. In a small charity, with a simple structure and uncomplicated activities, the reasons might include:

a) The risk of unforeseen emergency or other unexpected need for funds, eg an unexpected large repair bill or finding 'seed-funding' for an urgent project.

b) Covering unforeseen day-to-day operational costs, eg employing temporary staff to cover a long-term sick absence.

c) A source of income, eg a grant, not being renewed. Funds might be needed to give the trustees time to take action if income falls below expectations.

d) Planned commitments, or designations, that cannot be met by future income alone, eg plans for a major asset purchase or to a significant project that requires the charity to provide 'matched funding'.

e) The need to fund short-term deficits in a cash budget, e.g. money may need to be spent before a funding grant is received.

If, after considering the above, you think that reserves are needed please go to question 2. If you conclude that your charity does not need to hold any reserves, then you must explain that in your annual report.

Question 2. How much do you need in reserve?

The reserves level may be a target amount or a target range. For example, for each reason set out in question 1:

a) An amount might be needed to meet an unforeseen emergency or other unexpected need - consider risks and how much might be needed for such contingencies; this will involve judgement of events that may occur and their likelihood.

b) Look at your expenditure budget - do you need a small contingency fund to meet unforeseen operational costs?

c) Uncertainty over future income might mean having reserves equivalent to a number of weeks of income equivalent to a range of £x to £y, to allow time to develop new sources of income or to cut-back on related expenditure.

d) A planned spending commitment which cannot be met from future income would imply a need for a specific sum to be set aside - often this amount will be included within designations in accounts.

e) An amount might be needed to cover 'troughs' in the cash budget - review budgets to ascertain how much might be needed.

In summary, the financial risks you identify should influence the amount of reserves you target to hold and be explained in your reserves policy.

Setting a reserves policy is not a task undertaken in isolation. A reserves policy is a product of a charity's strategic planning, budgeting and risk management processes. These processes provide trustees with the information they need to establish exactly why they might need reserves and to help them quantify that need. The steps involved in these processes are interrelated with the outcome of one process informing another. For example, identified financial risks will inform both budgeting and the reserves policy. Setting a reserves policy can be approached in different ways.

<u>Step 1 - Understanding the nature of charitable funds held;</u>
<u>Step 2 - Identifying functional assets;</u>
<u>Step 3 - Understanding the financial impact of risk;</u>
<u>Step 4 - Reviewing sources of income;</u>
<u>Step 5 - Impact of future plans and commitments;</u>
<u>Step 6 - Agreeing a reserves policy.</u>

Foreshore Trust (FST) **APPENDIX 3**

Financial Risks

	Service	Potential Risk	Risk Rating (Likelihood / Impact)	Potential Impact	Responsibility for controls	Steps to mitigate risk, time frame for implementation and latest position
1	FST	Income Loss of Visitors to Hastings e.g. Major Pollution incident, water quality, major disaster elsewhere in Hastings.	Medium / High	- Budget deficit - Loss of 6 months income would equate to around £½m	- Head of Finance - Chief Accountant	- ensure regular budget monitoring reports distributed followed up by meetings - report variances to Charity Committee so any budget deficits can be addressed - report variances at each meeting - Maintain adequate Reserves
2	FST	Maintain Buildings and Infrastructure - Need for a long term repair and renewal programme	Low/Medium	- Build up of urgent and costly repairs (Planned maintenance reduces costs)	Building Services	Production, maintenance and regular review of repair and Renewal programme – based on regular inspection of assets. Ensure compliance of lease obligations Maintain and accumulate sufficient funds to finance agreed programme
3	FST	Unforeseen operational expenditure	Medium/Medium	- Reputation damage - Unable to meet commitments - Legal liabilities	Environmental Services	- Insurance - Maintain adequate Reserves
4	FST	Treasury Management - cash flow - Loss of money/fraud/theft - Reduction of investment Interest - Cost of borrowing	 Low/Medium Low / High Low / Low Low / Low	- Trust balances of £2m	Head of Finance	- Use of External Advisers - Sector - Ensure staff are well trained - Insurance cover in place for potential fraud and dishonesty and theft - Insurance cover in place for loss of Money - Maintain adequate Reserves
5	FST	Cash collection contract		- Loss of money (up to	Head of Finance	- Continue daily monitoring of cash banked

		- Firm collapses - Theft by company	Low / Low low / Low	£200k)		- Regular communication with supplier if the contract is not complied with - Insurance
6	FST	Uninsured properties / risks	Low / Medium	- Properties not insured - Loss of money in the event of uninsured loss	Head of Finance	- Ensure thorough renewals process each year - Make sure we liaise with estates/building services to ensure all properties are properly insured.
7	FST	Business Continuity	Low/ High	- Loss of Income, - Payments not made, - Treasury Management – financial loss	- Head of Finance/Chief Accountant	-Robust HBC financial systems - HBC business continuity planning
8	FST	Loss of key staff	Low / Medium	- Stress - Errors / omissions - Financial loss - Poor advice	- Chief Accountant - Head of Finance - Personnel, Policies and Strategies - Directors	- Keep staff motivated - Ensure knowledge is shared - Terms and Conditions
9	FST	Changes in legislation - Financial accounts compliance with Charity SORP	Low / Medium	- Failure to produce accounts - Qualified by auditor - Staff time - Staff costs -Reputation undermined	- Head of Finance - Chief Accountant	- Work with Manningtons experienced firm - Regular liaison with HBC external auditors (PKF) - Train staff
10	FST	Budget settings - No decisions - Late decisions - No processes	Low / Medium	- Poor Financial Management -	- Head of Finance - Chief Accountant	- Ensure regular budget monitoring reports distributed. - Report variance reporting through performance review - Provide appropriate financial advice to

						members and officers - Consider Whole life costing of decisions/ projects - Consider Revenue Implications of new projects
11	FST	External suppliers - Bankruptcy, Administration	Medium / High	- Depends which contract	- Chief Accountant	- Financial health checks on contracts
12	FST	Legal Liabilities - Public liability e.g. injury on trust land	Medium/Medium	- Financial Loss - Reputation	-Head of Finance	- Insurance Cover - Adequate reserves for uninsured losses or legal penalties/compensation claims.

APPENDIX 4

Foreshore Trust - Reserves Policy

This policy will be reviewed on a regular basis to take account of changes to the future plans of the Trust and perceived risks. Reserves are maintained for a variety of reasons as identified below. Namely:-

a) An amount might be needed to meet an unforeseen emergency or other unexpected need. This amount is arrived at after considering risks and how much might be needed for such contingencies; this involves judgement of events that may occur and their likelihood.

Whilst all the risks have yet to be fully assessed and reviewed it is suggested that £100,000 be retained to meet an unforeseen emergency or other unexpected event.

b) Expenditure budget - a small contingency fund to meet unforeseen operational costs

The expenditure budget is some £862,800. It is suggested that a 10% contingency (say £86,000) be retained for unexpected and unforeseen operational expenditure.

c) Uncertainty over future income. Most well run organisations retain reserves equivalent to a number of weeks or months of income equivalent to allow time to develop new sources of income or to cut-back on related expenditure.

Potential significant loss of income could result from a downturn in economic activity or an increase in fuel costs resulting in fewer tourists, a major disaster in the area, bad weather, pollution incident, or loss of reputation e.g. bathing water deterioration, etc.

It is recommended that the equivalent of 6 months income be retained to cater for this risk which would amount to around £½ million.

d) Planned spending commitments which cannot be met from future income would imply a need for a specific sum to be set aside - often this amount will be included within designations in the accounts.

Given the predicted surplus for each year there is scope to include some of the recurring planned expenditure within the annual budget. There are higher cost initiatives e.g. resurfacing of car parks, roadways, etc, that will necessitate identification and retention of significant sums within the accounts

e) Cash Flow – organisations require a working balance to cover 'troughs' in the cash budget.

Based on the financial year the cash flow is expected to be positive throughout the year i.e. income generated should exceed expenditure. Where significant one off expenditure is incurred e.g. resurfacing, use of reserves would be used to cover any shortfalls. As such no sum is set aside for this specific purpose – especially given the sums detailed above (a to d).

f) In summary the Reserves to be retained amount to :-

Ref.	Risk Area/ Designated Funds	Amount (£)
a)	Unforeseen emergency/event	£100,000
b)	Unforeseen operational costs/contingency	£86,000
c)	Uncertainty on Income streams	£500,000
d)	Planned Spending Commitments e.g. R&R	£682,000
	Total	£1,368,000