

GENERAL OPTICAL COUNCIL

Draft Policy on the Management of Council's Financial Reserves

Background

Over the past twelve months, the Finance and Procedure Committee have been reviewing the appropriateness of the current reserves policy. The current policy, which was approved by Council in July 2004, is that Council would maintain reserves at a level of *50% of planned annual expenditure*.

This level had been maintained for a number of years, but over the last three years had risen above this benchmark as a result of increasing operating surpluses particularly in years 2005/6 and 2006/7.

Policy Proposal

At its meeting in February 2008, the Finance and Procedure Committee considered a proposal to base its reserves policy on a risk based evaluation across four key areas:

- working capital
 - risks associated with a loss of Council's income
- buildings and premises
 - damage to, repair of and denial of access to Council's premises at 41 Harley Street
- a general contingency reserve
- regulatory reserve
 - legal costs associated with FTP, prosecutions, changes in legislation etc

The Committee considered what level of total reserves might be appropriate for each of these areas based on a risk evaluation. Each risk was assigned a weighting as to the *probability* of an event occurring and the *significance* of that event upon the financial position of the Council. A weighting of between 1 (lowest) and 5 (highest) was used for each criteria giving a maximum weighting of 25 and a lowest of 1.

Risks which scored at the highest level, say above 20, should be removed from reserves and become budgeted items since their weighted score should be considered a liability. Risks with lower scores would have the weighting applied to the gross level of risk.

For example:

A risk with a gross reserve of £100,000 with a weighting of 10 was assigned an adjusted reserve value of $£100,000 \times 10/25 = £40,000$.

Annex 1 shows the results of applying this formula across each of the risks identified. The adjusted reserve value for each of the four key areas is:

- working capital	£283,640
- buildings and premises	£33,000
- contingency reserve	£165,120
- regulatory reserve	<u>£1,590,000</u>
Total	£2,071,760

Council's reserves as at 31 March 2008 are reported in the latest financial statements at £2.397m, which indicated that reserves held were slightly higher than the calculated level.

Independent Audit

Council's auditors, Baker Tilly, were asked to give their comments on the revised draft policy and concluded they were happy with the methodology used. They considered a key point was to have a transparent methodology behind continuous assessment of the policy. They recommend that the formula for calculating the 'adjusted reserve figure' be explained more clearly and that included in the accounts was a brief explanation as to the methodology behind each of the four key reserve funds in order to demonstrate to the reader the thought process applied.

Recommendations

The F&P Committee noted that based on the methodology used:

- that reserves were adequately covered as at 31 March 2008 at a level of **£2.397m**, and
- that the Finance and Procedure Committee would be responsible for reviewing the policy and that this be carried out on an annual basis
- the draft proposal be recommended to Council for approval.

The Audit Committee considered the draft proposal on 12 June 2008 and noted:

- they were content that the draft policy adequately addressed the issue of risk and that due process had been followed in the development of the policy
- that the risk assumptions be reviewed annually along with the scoring methodology to ensure the policy was kept up to date
- that Council's reserves should be reported against these four reserve funds as from financial year 2008/9. Some reference as to how the policy had been arrived at should be made within the statutory accounts, together with the process adopted to review it on an ongoing basis

Council is asked to receive and adopt the draft policy on the management of its financial reserves.