Finance and Resources Committee –17 March 2011

Financial reserves policy

Executive summary and recommendations

Introduction
This paper relates to the HPC Reserves policy review.

Decision
The Committee is requested to review the attached document and approve the continuation of the Reserves Policy, as appropriate.

Background information
The Reserves policy was last reviewed by the Committee at their March 2009 meeting. The latest copy of the policy is attached – see Appendix One. No further changes are proposed at this time.

The Finance and Resources Committee may wish to review the policy in two years after the Social Workers have come onto the register and gone through the initial on-boarding cycle.

The calculations shown in Appendix Two have been updated to reflect actual values for years ending March 2009 and March 2010, the forecast year end to March 2011 and the latest draft budget data for year ending March 2012. The last two years shown are as originally stated in last approved the 5 year plan.

Resource implications
Nil

Financial implications
Nil

Appendices
Appendix One – HPC Financial Reserves Policy
Appendix Two – Reserves Policy Forecast

Date of paper
7 March 2011

APPENDIX ONE

HEALTH PROFESSIONS COUNCIL (HPC)

RESERVES POLICY

INTRODUCTION

HPC commenced operations on 1st April 2002 inheriting the net assets, general funds and revaluation reserves of the Council for Professions Supplementary to Medicine (CPSM). A private meeting of the Council in October 2004 ratified the September 2004 proposed policy that sufficient Reserves should be held to cover three months overheads. The Reserves policy was last approved by the Finance and Resources Committee in March 2009.

1.0 Reserves definitions

Reserves have been defined as accumulated profits (surpluses) that have been retained by a company (the organisation), plus any surplus from the revaluation of assets, plus any share premium. Reserves belong to shareholders (stakeholders) and are part of shareholder's funds.

In s92 (c) of the Company's Act 2006, reserves are referred to indirectly as follows; the amount of the company's net assets is not less than the aggregate of its called up share capital and undistributable reserves. s831 (4) defines undistributable reserves as the share premium account plus the capital redemption reserve plus the amount by which accumulated unrealised profits exceed its accumulated unrealised losses plus any other reserve that the company is prohibited from distributing.

A useful guide for HPC would be the define reserves as the sum of Investments and Working Capital, as this is readily convertible to cash in the short term.

2 RESERVES POLICY

2.1 **That HPC maintain a Reserves level that is a MINIMUM of three average months budgeted operating expenses.**

2.2 **That HPC maintain sufficient Reserves to fund the replacement of assets (purchased or leased) that are used in the business for ongoing operations.**

By definition, assets have a useful economic life greater than one year. They are depreciated over their useful life e.g. four years for most computer assets. If HPC needs to replace those assets at the end of their economic life to at least maintain existing services and service levels, sufficient reserves must be built up to do so. As HPC grows in size, the investment in assets increases, so the level of Reserves must increase to ensure the assets can be replaced.

2.3 **That sufficient Reserves be held to preserve operating flexibility within the business to handle external "shocks".**

HPC develops annual and Five Year Plans based on the most likely and agreed targets for the business. However, some external events may arise with rapid and significant impacts on HPC operating activities that are outside the plans. Examples include; lost legal cases, legislative penalties and costs imposed on HPC by central government agencies, the unanticipated withdrawal of a profession and/or sector-restructuring.

If HPC has a significant level of Reserves built up, these will in the short term provide “bridging finance” to handle such “shocks”. A significant level of Reserves also generates income (interest income etc) to help “smooth out” and delay Registrant fee price increases.

2.4 **That the Reserves Policy be viewed in the context of the Five Year Financial Plan “bottom line” surpluses/deficits and the Investments Policy.**

Arguably, the Reserves policy both influences and is influenced by the Five Year Financial Plan. To elaborate, if high Reserves levels are to be built up or maintained, this will drive the need to increase fee income (find more fee-paying Registrants and/or raise fee prices). Similarly, if a Five Year Plan is agreed, Reserves levels will be an output of this. If those levels conflict with the prevailing Reserves policy, the policies will need to change, to produce an alignment.

Reserves levels will also be a function of volatility in the value of the things comprising those reserves. Regarding relative volatility (uncertainty) over the next 12 months, share, bond and property market values are considerably more volatile than fee income, especially fee income relating to the existing professions that HPC regulates.

Regarding the relationship between the Reserves Policy and the Investments Policy, in the medium term, if fees are not able to rise to offset cost increases, but ongoing compliance with the agreed Reserves policy is maintained, then investment returns need to rise. However, higher investment returns will typically involve incurring increased investment risk (more value volatility and/or greater potential for losses).

Finally, it is worth noting that if HPC’s underlying cash-flows become highly volatile, then either HPC needs an overdraft (indicative interest rates are about 2 percentage points about the Bank of England base rate), or the Reserves “buffer” in the absence of a bank overdraft, needs to be correspondingly higher.

APPENDIX TWO

Reserves Policy Forecast

	2006/2007 Actuals	2007/2008 Actuals	2008/2009 Actuals	2009/2010 Actuals	2010/2011 F'Cast	2011/2012 Budget	2012/2013 Yr 3	2013/2014 Yr 4
Investment value	1,848,268	1,528,047	1,347,418	1,926,067	0	0	0	0
Working Capital	2,449,205	3,009,674	3,042,091	4,300,270	6,415,000	6,307,259	17,600,070	23,994,479
Total available	**4,297,473**	**4,537,721**	**4,389,509**	**6,226,337**	**6,415,000**	**6,307,259**	**17,600,070**	**23,994,479**
Five Yr Plan Op Expenses (Nov 2008 version)	10,502,421	11,577,514	12,925,680	15,004,279	16,474,000	17,300,000	24,233,000	26,332,000
3 avg mths of Op Expenses (Policy target)	**2,625,605**	**2,894,379**	**3,231,420**	**3,751,070**	**4,118,500**	**4,325,000**	**6,058,250**	**6,583,000**
Difference	1,671,868	1,643,343	1,158,089	2,475,267	2,296,500	1,982,259	11,541,820	17,411,479
Ratio of Closing CF to WC	1.65	1.63	1.76	1.31	0.87	0.87	0.87	0.87
Closing Cashflow (Five Year Plan Nov 2008 version)	4,049,524	4,899,109	5,341,865	5,649,422	5,608,000	5,513,813	15,386,000	20,976,000
Forecast in £000's	4,297	4,538	4,390	6,226	6,415	6,307	17,600	23,994
Three mths holdings target in £000's	2,626	2,894	3,231	3,751	4,119	4,325	6,058	6,583