Reserves Policy Statement

Introduction/Context

The SDT is funded by the Law Society (TLS), subject to approval by the Legal Services Board (LSB) of an annual budget. The SDT submits its budget application to the LSB in September of each year.

As part of discussion and agreement of the SDT's 2019 budget, the LSB, at its October 2018 Board Meeting, asked the SDT to put forward a proposal for a Reserves Policy.

This paper includes the rationale, purpose, scope of and alternatives to the proposed Reserves Policy and sets out a Reserves Policy Statement to be adopted by SDTAL for inclusion in the Statutory Accounts.

Purpose of a Reserves Policy

The purpose of a financial reserve is to provide certainty about the availability of operating and investment funds, enabling the SDT/SDTAL to meet its business objectives and take a strategic, long-term approach to business planning, and function independent of the LSB and TLS.

Under the current arrangement the SDT statutory accounts report apparent significant deficits, despite the organisation operating within its annual budget. This has been an agreed mechanism with TLS under the Memorandum of Understanding to reduce reserves which had built up over several years through historic underspends on a gradual basis. This undermines the SDT's ability to operate independently. It has also had the effect of making it difficult for the SDT to open credit accounts with suppliers. One example of this is the Trainline account, where it took a considerable amount of time to persuade the Trainline that the SDT was able to meet its future liabilities, without a parent company guarantee.

Historically capital expenditure has been funded through underspends on the revenue account. This has, on some occasions, impacted on business planning e.g. work being commissioned or capital purchases made within a restricted timeframe, because of uncertainty about available funding beyond the end of the current budget year. Holding reserves would enable the SDT to plan further ahead and make rational business decisions within appropriate timescales.

Because of the SDT's particular funding arrangements, the parameters which apply to a conventional (e.g. a fundraising charity) reserves policy do not apply. Primary legislation would be required for a major change in the SDT's scope, purpose or funding arrangements. The reserve fund is not therefore intended to absorb large scale expansion or contraction/windingup, or to fund major business change. It is assumed that these would be anticipated and factored into the normal business planning process.

<u>Scope of the reserve fund</u>

Reserves would be held typically for use in the following situations:

<u>Investment in the business</u>

The reserve could be used to provide guaranteed up-front funding (including capital expenditure), enabling the SDT to invest in projects/contracts or take advantage of opportunities to deliver business improvements or savings, where the economic impact of expenditure is spread over more than one year.

It could also be used to fund contractual commitments over several years e.g. for commercial/financial advantage.

<u>Economic changes</u>

The reserve could be used to meet additional costs resulting from changes in the economic, social, legislative and political environment e.g. implement changes to comply with new or amended legislation, or to pursue corporate social responsibility commitments etc.

<u>Unexpected events</u>

The reserve could be used to respond to increases in expenditure resulting from unanticipated events or situations, including (but not limited to):

- Unanticipated building lease costs e.g. increase in service charge, rent etc
- Significant building/maintenance costs
- Increase in business rates beyond what has been budgeted
- Increase in the number of sitting days
- Unexpected increase in recruitment activity due to unforeseen staff turnover
- Uninsured legal costs
- Significant increase in inflation
- Legislative changes – e.g. GDPR, further pension reform, NI reform etc
- Business continuity costs
- Uninsured losses or to provide cash flow funding pending insurance claims.

Alternatives to holding reserves

In the past, the SDT has adopted alternative approaches to budgeting, in the absence of having sufficient reserves. These have included:

- Overly cautious budgeting in some or all budget lines. This typically results in a surplus at the end of the year, as has happened in some previous years.
- Including a contingency line in the budget for items or events which are anticipated but for which the outcome cannot be predicted e.g. the recent rent increase.

Policy Statement

The SDTAL Policy Statement is as follows:

SDTAL is funded by the Law Society (TLS), subject to approval by the Legal Services Board (LSB) of an annual budget application for the following financial year.

SDTAL's Reserves Policy seeks to establish and maintain general reserves at a minimum level. General reserves are funds that are freely available to spend and do not include tangible fixed assets and amounts designated for essential future spending. The SDTAL Board reviews the minimum level of general reserves at least annually.

SDTAL also intends to establish a designated reserve to be funded by under-spends in Members' fees in financial years when the actual number of sitting days are lower than the number budgeted. The first call on this designated reserve will be to fund excess sitting days in the years when they exceed the budgeted allocation.

The target minimum level of general reserves is set to ensure SDTAL's financial independence and sustainability, taking account of the security of its income stream, cash balances and an assessment of the potential financial impact of risks faced by SDTAL. The target minimum level of general reserves is set to ensure that resources are applied effectively, balancing the cost of regulation with the quality of service provided to the legal profession and the public.

Once the target minimum level of general reserves has been reached, surplus funds will be returned to TLS in the financial year following the approval of the Statutory Accounts i.e. 2 years in arrears or in a manner to be agreed by the parties (TLS and SDTAL).

In August 2019 the SDTAL Board reviewed the latest position regarding the Reserves Policy and agreed that the target for the minimum level of general reserves should be £500,000.

Current Reserves

As at 31 December 2018 the SDT held reserves of just over £530,000, of which a little under £256,000 is being returned to TLS this year through a reduction to budget funding. As a consequence of the adoption of this policy no further past surpluses will be returned to TLS after the end of 2019, until the target minimum level of general reserves is achieved.

Conclusions

The SDT/SDTAL Board approved this Reserves Policy and the Policy Statement on 28 August 2019.

SDT/SDTAL
September 2019