Reserves Policy

Executive Summary

The HCPC's reserves policy was last updated in March 2020, which set out the requirement for positive reserves by setting the target in line with Positive Realisable Net Assets (refers to a situation in which an organisation's assets, when sold or converted into cash, exceed its liabilities, i.e. the organisation has more valuable assets than it owes in debts).

The updated policy seeks to build on this further by setting an aspiration to maintain reserves at three months of operating expenditure, which would be equivalent to around £10m. That would help us mitigate financial risks to our financial viability and ability to fulfil our statutory responsibilities. However, at present it would be difficult to set a clear timetable for when we could achieve reserves at this level.

Taking account of feedback on the draft from the People and Resources Committee, the draft revised policy maintains the current requirement to maintain at least positive realisable net assets but buttresses it with the aspiration described above. Advice being submitted separately to the Council on fees, and on the draft 2024-25 budget and medium-term plans, provides information about our medium-term financial position under various scenarios.

Our latest forecast is for total reserves as at 31 March 2024 to be £3.2m and net realisable assets of £133k, which is equivalent to only just over one day of operating expenditure.

Other changes include a more focused presentation of what the reserves policy seeks to achieve and the principles that will be governing the management of reserves.

Previous consideration	Audit and Risk Assurance Committee (ARAC) – 20 September 2023 People and Resource Committee (PRC) – 28 February 2024
Decision	The Committee is asked to recommend the reserves policy to Council.
Next steps	If recommended, the reserves policy will be presented to Council for approval in March 2024.
Strategic priority	Financial sustainability.
Financial and resource implications	The implications are set out in the report.
EDI impact	No direct implications.

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RESERVES POLICY

1. Introduction

1.1 Financial reserves are funds that an organisation sets aside from its income and any surplus to cover unexpected events and financial challenges and for other specific purposes. Reserves are held in various forms, including cash, investments or other easily accessible assets. Financial reserves contribute to an organisation's financial stability and resilience. The objective of a reserves policy is to establish guidelines and principles for managing financial reserves in a responsible and transparent manner.

2. Principles and objectives of the HCPC's reserves policy

2.1 The HCPC has adopted the following principles to underpin its reserves policy:

- **Financial viability:** the HCPC must be financially viable for us to fulfil our statutory responsibilities; this requires us to maintain an adequate level of financial reserves to withstand unexpected financial challenges or shortfalls in in income and mitigate risks, in addition to having sufficient funds to support our operational activities. In setting the level of our reserves to ensure financial viability we need to have regard to the requirement in our legislation to meet our costs out of income from registrants' fees.[1]

- **Proportionality:** our reserves should be proportionate to need and be affordable within our funding base, without putting patient safety at risk. Setting reserves too low increases the likelihood that, if an unexpected financial event occurs, fees would have to be increased beyond planned levels, which increases uncertainty for registrants. If reserves were too high, that could attract challenge: hence our commitment to transparency about the management of our reserves and how we use them.

- **Risk management:** identify and mitigate financial risks that could impact our ability to fulfil our regulatory responsibilities.

- **Flexibility:** enable flexibility in addressing unforeseen risks and challenges without compromising fulfilment of our statutory and quality of service responsibilities.

- **Transparency and accountability:** ensure transparency in how reserves are managed and allocated in fulfilling our statutory duties.

- **Enable strategic investments:** enable us to invest in improvements that will generate benefits for public safety and in the quality of service we provide to registrants, as well as securing a financial return on our reserves, consistent with

[1] The Health Professions Order 2001, Article 45

the risk appetite and approach set out in our investment policy, with any returns reinvested into fulfilling our regulatory functions.

3. HCPC Reserves Policy

3.1 The HCPC’s policy is to maintain at least positive realisable net assets, defined as total net assets less the value of intangible assets. We aspire to increase reserves to a level beyond that, proportionate to the risks and opportunities that we face, and in step with progress against our wider financial sustainability strategy, having regard to a benchmark for total reserves defined as the equivalent of three months of operating expenditure, in line with wider norms across the economy.

3.2 As financial circumstances can change over time, we review our reserves policy annually to ensure it continues to be appropriate to our circumstances.

3.3 The reserves policy forms part of the HCPC’s corporate governance framework. It is also consistent with HM Treasury’s guidance for the financial management of public bodies[2]. The National Audit Office (NAO) and Parliament need to be assured that the HCPC can continue to deliver its statutory regulatory functions; our reserves policy contributes to providing this assurance.

4. Background

4.1 When setting medium term financial plans we consider the level of reserves in light of the principles and policy set out above. We set out income and expenditure plans on a three-year cycle, including any action necessary to replenish the reserves if they are projected to fall too low.

4.2 In accounting terms, we recognise reserves on the Statement of Financial Position as part of equity or net assets. Reserves represent the retained earnings or accumulated funds that have been set aside for general purposes. The total value of reserves equals the value of the net assets in the Statement of Financial Position.

4.3 Reserves can be categorised into different types based on their intended purpose and usage, including:

- **General Reserves:** These are reserves that are not earmarked for any specific purpose. General reserves provide flexibility and act as a financial cushion to address unforeseen expenses or operational needs.
- **Free Reserves:** These are a subset of general reserves and represent the surplus that can be used for discretionary purposes, such as reinvesting in the organisation. Free reserves are the retained earnings that are not legally or contractually tied to specific obligations, liabilities or capital requirements.
- **Revaluation Reserve:** This is the accumulated amount resulting from the revaluation of certain assets or liabilities, such as property, plant, equipment or

[2] https://www.gov.uk/government/publications/managing-public-money

investments. The revaluation reserve is used to record the increase in the value of these assets due to changes in market conditions or other factors.

- **Revenue Reserves:** Revenue reserves are accumulated from surplus revenues and can be used to support ongoing operations, address budgetary shortfalls or fund strategic initiatives.
- **Specific Provision Reserves:** These reserves are created to account for specific potential expenses, losses or obligations and help ensure that funds are available when specific financial obligations arise.
- **Investment Reserves:** Investment reserves are funds set aside for investment purposes with the goal of generating returns that can support financial sustainability.

4.4 General reserves and cash are both important financial components but serve different purposes and are treated differently in accounting terms. While general reserves provide financial stability and flexibility for various purposes, cash represents the immediate liquidity and resources available for day-to-day operations and transactions.

Appendix – Interim Reserves Policy and Mitigations

The policy aims to ensure that the organisation has sufficient working capital to meet day-to-day running costs after considering the long-term commitments and potential risks.

We were not compliant with our reserves policy as of 31 March 2023. This year-end position was impacted by several one-off factors, including a provision for potential legal liabilities, and FTP legal costs brought forward. But even after allowing for these factors we were still around £1 to 1.5m adrift against the policy, which is fundamentally a product of our fee income shortfall.

At its meeting on 14 June 2023, the Audit and Risk Assurance Committee (ARAC) discussed an interim approach to our reserves in view of the current non-compliance with the policy. ARAC noted several mitigating factors for the risks created by this non-compliance:

- The HCPC's significant cash balance, relating to the fees renewal cycle for individual professions.
- The HCPC's statutory status, which creates an ongoing requirement for the HCPC as an organisation to provide the regulatory functions for which we are statutorily responsible.
- The level of demand from international applicants, giving a contribution to corporate overheads and the bottom line after direct costs.
- The improvements in financial management that the HCPC has recently made, including setting a balanced budget for 2023/24 and developing a balanced draft budget for 2024/25.
- The development of a financial sustainability strategy, including the current fees review; establishing medium-term projections as a framework for financial planning; the intention to move to more regular fee reviews in future; and the hope that regulatory reform will in future enable us to secure changes to our fee-setting powers.
- A continued programme of cash-generating efficiencies, including investment in further system and process improvements, subject to capital affordability.

These mitigations give assurance that the HCPC remains financially viable and a going concern, while highlighting the importance of continued strong financial management and regular fees reviews to address our funding gap.