Council

20 March 2024

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 (referring 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.

Following review by the People and Resources Committee and the Audit and Risk Assurance Committee, the draft revised policy therefore continues with the current requirement to maintain at least positive realisable net assets but buttresses it with the aspiration described above. Advice going separately to the Council 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 for net realisable assets of £133k, which is only equivalent to 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 govern the management of reserves.

Previous consideration	People and Resources Committee (PRC) – 28 February 2024 Audit and Risk Assurance Committee (ARAC) – 13 March 2024 The Council previously reviewed and approved the Reserves policy at its meeting in March 2020.
Decision	The Council is asked to approve the revised policy.
Strategic priority	Financial sustainability.
Financial and resource implications	The implications are set out in the paper.

EDI impact	No direct implications.
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Reserves Policy

Introduction

Financial reserves are funds that an organisation sets aside from its income and surplus for 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.

Principles and objectives of the HCPC's reserves policy

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 reserves to withstand unexpected financial challenges such as shortfalls in income and to mitigate risks, in addition to having sufficient funds to support our operational activities. In setting the level of 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 public 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 service we provide to registrants, as well as securing a financial return on our reserves, consistent with the risk

[1] The Health Professions Order 2001, Article 45

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

The HCPC reserves policy

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.

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

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.

Background

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.

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.

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

- **General reserves** are not earmarked for any specific purpose; they provide flexibility and act as a financial cushion to address unforeseen expenses or operational needs. However, within general reserves, an organisation can create or recognise specific categories of reserves for particular purposes, including the following:
    - **Net realisable assets** focus on the value of assets available to cover liabilities. In the HCPC's case, as noted, our policy is defined in relation to this category, though with an aspiration to go further. In practice this means taking

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

the value of total net assets less the value of intangibles, which are primarily software.

- **Specific provision reserves** can be created to account for specific potential expenses, losses or obligations and help to ensure that funds are available when specific financial obligations arise.

- **Revaluation reserve** is the accumulated amount resulting from the revaluation of certain assets or liabilities, such as property, plant, equipment or 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.

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 Fitness to Practise (FTP) legal costs brought forward. But even after allowing for these factors we were still around £1m 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. The 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.