People and Resources Committee

28 February 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 (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 with the aim to maintain reserves at three months of operating expenditure, as adjusted for financial risk, with a maximum of six months of operating expenditure. This is to ensure we avoid situations where setting reserves too low increases the likelihood that, if an unexpected financial event occurs, fees have to be increased over a short period, which increases uncertainty for registrants. Also, If reserves are too high, they may attract challenge, hence a maximum threshold being set.

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	People and Resource Committee (PRC) – 7 September 2023 Audit and Risk Assurance Committee (ARAC) – 20 September 2023
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 final 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. Summary of Reserves Policy

1.1. Financial reserves contribute to an organisation's financial stability and resilience, allowing it to respond to various financial needs and opportunities. The objective of a reserves policy is to establish guidelines and principles for managing financial reserves in a responsible and transparent manner.

1.2. Reserves, in a financial context, refer to funds that an organisation sets aside from its income and surplus for specific purposes, such as addressing future uncertainties, unforeseen expenses or other financial needs. Reserves are typically held in various forms, including cash, investments or other easily accessible assets. They serve as a financial cushion to ensure an organisation's stability, continuity and ability to meet its obligations in the face of unexpected events or financial challenges.

1.3. For the HCPC, which is responsible for overseeing the health and care sector's standards and compliance, having a well-defined reserves policy is essential to ensure financial stability, operational continuity and effective regulatory oversight. The HCPC's Reserves Policy ensures we maintain an appropriate level of financial reserves to protect the organisation from events that would have a significant impact, such as a substantial loss of income or a sudden major increase in expenditure.

1.4. The HCPC aims to maintain reserves at a level that is not excessive and also does not put solvency at risk. Our policy is to maintain reserves at three months of operating expenditure, as adjusted for financial risk, with a maximum of six months of operating expenditure.

1.5. As financial circumstances can change over time, we aim to review our reserves policy annually to ensure it continues to meet our requirements.

2. Objective of the Reserves Policy

2.1. The reserves policy is part of the HCPC's corporate governance framework and is consistent with our legislation and our strategic intent. It is also consistent with HM Treasury's guidance for the financial management of public bodies[1]. The National Audit Office (NAO) and Parliament need to be assured that the HCPC can continue to deliver its statutory duties and our financial sustainability strategy contributes to providing this assurance.

2.2. This policy establishes guidelines and principles for managing the HCPC's financial reserves in a responsible and transparent manner, to help ensure financial sustainability to enable the HCPC to fulfil its statutory regulatory functions.

2.3. In accordance with these principles the main objectives of the policy are:

- **Financial Stability:** Ensure that we maintain an adequate level of financial reserves to withstand unexpected financial challenges, economic downturns or fluctuations in funding.
- **Risk Management:** Identify and mitigate financial risks that could impact our ability to fulfil our regulatory responsibilities, ensuring that we have the necessary resources to address potential challenges.
- **Flexibility:** Provide flexibility in managing financial resources to address unforeseen circumstances without compromising the quality and effectiveness of regulatory services.
- **Transparency and Accountability:** Ensure transparency in how reserves are managed and allocated, promoting accountability to stakeholders and the public regarding our financial decisions.
- **Strategic Investments:** Enable us to secure some financial return on our reserves, consistent with the risk appetite and approach set out in our investment policy with any returns reinvested into fulfilling our regulatory functions.

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

3. Principles

3.1. Our legislation requires us to meet our costs out of our income from registrants' fees[2] and as the regulator of 15 health and care professions, our primary role is to maintain patient safety and public confidence. We have a legal obligation to assure standards of education, set policy on professional standards, maintain the register of professionals and investigate concerns. We must be financially viable to fulfil our statutory responsibilities by securing enough funds to not only support our operational activities, but also cover unexpected financial pressures in the form of unplanned expenditure or shortfalls in income.

3.2. The HCPC's policy is to maintain reserves equivalent to three months of operating expenditure in reserves and up to a maximum of six months of operating expenditure.

3.3. For the HCPC, setting reserves too low increases the likelihood that, if an unexpected financial event occurs, fees have to be increased over a short period, which increases uncertainty for registrants. If reserves are too high, they may attract challenge, hence our transparency regarding the management of our reserves and how we use them.

3.4. When setting expenditure plans as part of the financial sustainability strategy for the medium to long term (3 to 5 years), our budget planning cycle runs for several months. We conduct repeated rounds of reviews of income and costs, with the risks being carefully considered and challenged. We actively monitor the level of reserves during the year and if they are below or above the target, we consider whether this is a short-term situation or indicative of a long-term issue. We set our priorities and costed corporate plan on a three-year cycle and will take action to replenish the reserves if they fall too low.

3.5. As financial circumstances can change for any organisation over time, we aim to review our reserves policy annually with our Council Committee and the Audit and Risk Assurance Committee to ensure it continues to meet our requirements.

[2] The Health Professions Order 2001, Article 45

Appendix 1 - Definition of Reserves and Relationship to Cash

Reserves, in a financial context, refer to funds that an organisation sets aside from its income and surplus for specific purposes, such as addressing future uncertainties, unforeseen expenses or other financial needs. Reserves are typically held in various forms, including cash, investments or other easily accessible assets. They serve as a financial cushion to ensure an organisation's stability, continuity and ability to meet its obligations in the face of unexpected events or financial challenges. For the HCPC, reserves play a significant role in ensuring financial stability, operational continuity and effective regulatory oversight.

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. Some common types of reserves that would be relevant include:

- **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 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.

General reserves and cash are both important financial components but serve different purposes and are treated differently in accounting and financial management. 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. The nature of general reserves are non-specific and do not have a direct correlation to the amount of cash held by an organisation, while cash is a tangible asset and represents the immediate liquidity of an organisation used to make payments, cover expenses and fund daily operations.

Organisations can make surpluses and have positive reserves and still run out of cash, for example, if debts are not collected or if capital expenditure is excessive. Conversely, organisations can make deficits and have negative reserves, but still be able to continue over the short or medium term, for example, if customers have paid them in advance or if they have access to borrowings.

Cash or liquidity is essential for all organisations in the short and long term to provide working capital to undertake normal day-to-day business, to provide funds to deal with any risks[3] that materialise and to provide funds to respond to new initiatives, opportunities and challenges. Reserves are a source of cash, in that operating surpluses are eventually realised in cash, but they are not the only source of cash. Other sources of cash and liquidity include receipts in advance from customers (or in our context, registrants), access to borrowings[4] and trade credit, or in the private sector, share capital.

[3] For example, a legislative delay in implementation of a planned fee increase; the costs of major Fitness to Practise cases; or overruns on major projects.
[4] HCPC has the power to borrow, and it is likely that we could borrow at relatively low cost, because of the security of our fee income from registrants.

Appendix 2 – 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 continuing high-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.
- The development of a financial sustainability strategy, including the current fees review; establishing medium-term projections as a framework for financial planning; the potential to move to more regular fee reviews in future; and the expectation that regulatory reform will in future enable us to secure changes to our fee-setting powers.
- A continued programme of cash-generating efficiencies, including giving up leased estate and 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 the fees review to address our funding gap.