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Leighton Andrews AM
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Welsh Government
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Dear Minister,

Thank you for your correspondence of 23 October on local authority reserves. It coincided with our own data collection exercise that was undertaken with the support of SOLACE and the Society of Welsh Treasurers (SWT). The attached briefing summarises that information and highlights recent studies and guidance from regulators and CIPFA. I thought it would be helpful to share it with you.

I hope this national context complements the individual responses that you receive from local authorities, including my own. I note your officials have reviewed the latest accounts and have concluded that there has been no improvement in presentation due to ambiguity in definitions. This may be down to differences in accounting treatment and guidance needs to be tightened

Like you, I think it is not unreasonable for us all to understand better, and explain better, the position on reserves. To that end, I have requested that Treasurers put this on their agenda for their December or January meeting, once officials have digested the individual authority responses.

Yours sincerely,

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WLGA Spokesperson for Finance and Resources

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WLGA Briefing

Society of Welsh Treasurers
Chief Executives



Local Authority Reserves 10 November 2014

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Two recent Reports by the Wales Audit Office¹ and the Audit Commission² have emphasised the need for local authority reserves and why they may have risen in recent years. Appropriate levels of reserves are an important element prudent financial management and this is underpinned by legislation contained in various Acts. This is supplemented by guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) through its Local Authority Accounting Panel (LAAP)³.

Like CIPFA⁴, the WLGA would highlight 5 key points that are worth emphasising in the current economic context.

1. Reserves are an important component of councils' financial planning framework and are no panacea for financial problems created by austerity.
2. Judgements about reserves, and to what extent they should be used or set aside to meet either specific or unforeseen future liabilities, can only be made locally. Guidance on appropriate questions for members to ask is provided by the Audit Commission.
3. Local decisions should be taken by councillors having regard to clear and full information and advice provided by Chief Finance Officers (The WAO view is that there is room for improvement to make this more transparent and councils should ensure local protocols are in place).
4. Recent increases in aggregate levels of reserves reflect a general response to coping with austerity and building up funds for capital projects but councils are reporting increased appropriations from reserves over the next two years.
5. The future funding outlook is such that uncertainty and risk is increasing.

Latest Data Collection

With the support of SOLACE and SWT, the WLGA has recently collected data on reserves based on information in Statements of Accounts. Data from the Whole of Government Accounts (WGA) comes from Group Accounts which includes funds held by arms-length

¹ [Wales Audit Office\(2012\), Local Authority Reserves and Unsupported Borrowing](#)

² [Audit Commission \(2012\), Striking a Balance](#)

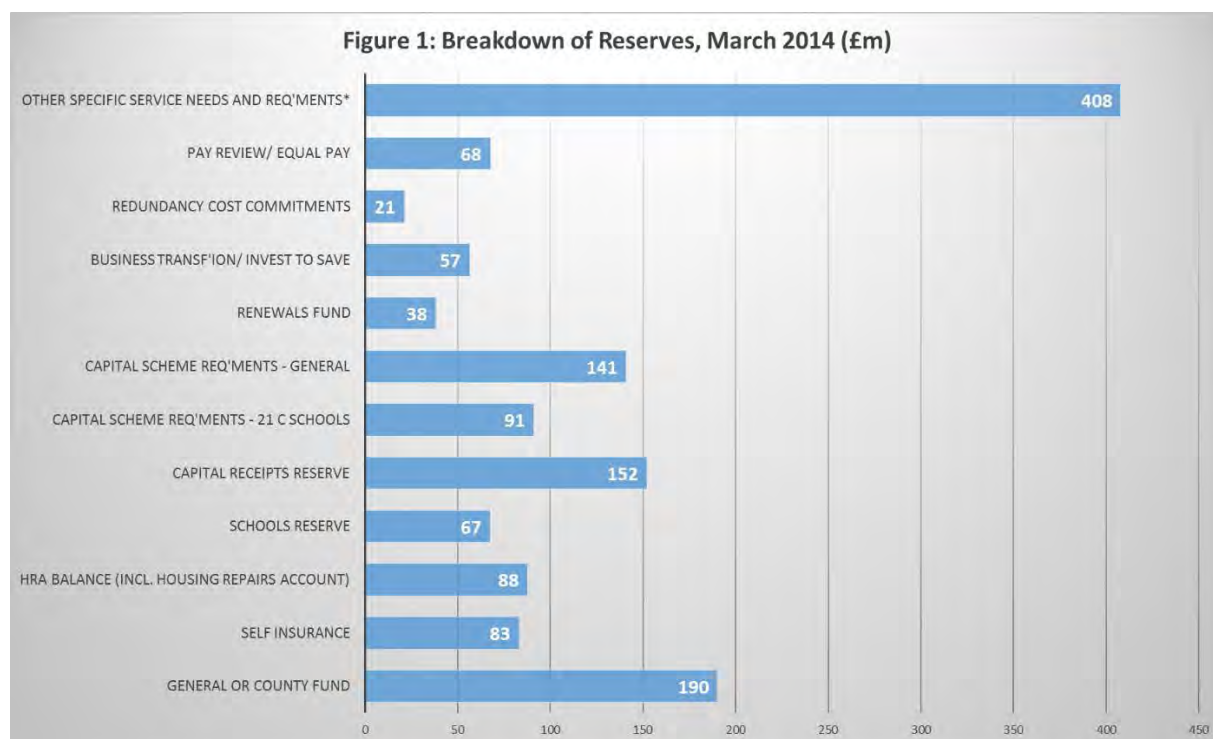
³ [CIPFA \(2014\), LAAP Bulletin 99 Local Authority Reserves and Balances](#)

⁴ [CIPFA \(2012\), Press Release: CIPFA Sets out position on reserves](#)

bodies. We tried as much as possible to reconcile the two sources and there is a small residual difference of around £2m.

While the WGA framework is useful, the terminology can be ambiguous or misleading. The term 'Usable' does not necessarily mean that cash-backed funds are available to the local authority to spend in a way that it can determine. Some funds support national initiatives such as Welsh Housing Quality Standards and Twenty First Century Schools which are integral to the Wales Infrastructure Investment Plan. Some categories of funds are rather technical but we have sought to break down as much as possible the 'other category'.

Despite the issue with terminology, 'Usable' reserves are held for contingent or planned purposes and they currently total £1.4bn. This figure is broken down into various elements set out figure 1 below.



General Balances

General Balances are a working balance to help cushion the impact of uneven cash flows. They are a contingency for unexpected events or emergencies. Around 14% of the total is held for these purposes and the remainder is for planned purposes and is earmarked. General Balances represent 2.7% of gross revenue spending (see figure 2 below). CIPFA and the Local Authority Accounting Panel prescribe no minimum or maximum level of reserves and advise that local authorities should establish reserves including the level of those reserves based on the advice of their chief finance officers.

Self-Insurance

Self-insurance is a used by a number of local authorities to meet potential and contingent liabilities. They are reported as earmarked reserves where these liabilities do not meet the definition of a 'provision' under the requirements of IAS⁵ 37 *Provisions, Contingent Assets and Liabilities*. These funds account for around 6% of the overall total.

Capital programmes & asset management

⁵ International Accounting Standard (IAS) 37 is incorporated into CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom.

Earmarked reserves also includes funds set aside for capital investment and maintenance of assets. The Capital Receipts Reserve is money set aside from sale of property to build and maintain other property. Capital Scheme Requirements is money set aside to build roads, bridges, and schools including 21st Century Schools. Some authorities have a Renewals Fund to replace 'depreciating' vehicles and other assets. These account for 30% of the overall total of reserves.

Business transformation and workforce planning

Earmarked Reserves are also held for transformation initiatives especially in relation to workforce or service reform where there is an invest-to-save aspect to one-off expenditure. Many local authorities operate their own Invest to Save Funds similar to that operated by the Welsh Government. There may be other funds to facilitate efficiency savings including business transformation schemes. Many transformation initiatives are a response to continuing austerity and this will impact on the workforce. Consequently, many local authorities hold funds for redundancy costs. Workforce planning also includes claims under equal pay which must be financed. These account for around 10% of the total.

Schools & HRA

Some funds are less accessible than others and their use is heavily prescribed. Schools reserves are the unspent balances of delegated school budgets. The Housing Revenue Account is currently ring-fenced which means that it is separate from other local authority income and expenditure streams. Local authorities have no discretion over the funds. These funds account for 11% of overall useable reserves.

Other earmarked reserves

This category of reserves covers all other funds. It accounts for nearly 29% or £408m of the total. From the data returns it wasn't possible to breakdown this any further but we know from additional memorandum items in the returns that there are significant sub-categories. Most prominent among these are PFI equalisation reserves and grants unapplied. PFI funds are held to even out the funding and expenditure profiles of PFI schemes. 'Grants unapplied' (revenue and capital) is an accounting treatment for receipts held in advance of spend. From additional comments we have had back in the data collection we know that both of these funds account for about a third of the total (around £142m).

There are potentially many other funds within this category. Many reported back funds held for arm-length bodies or partnerships such as joint committees. These can be quite significant, in one authority it represented 7.5% of overall reserves. Some authorities reported back service-specific reserves that address temporary demand peaks in high-risk, high-cost services such as special education needs. Others report specific projects such as ICT and waste that are part of service continuation rather than service transformation.

These should be highlighted in individual authorities' detailed responses to the Minister's letter of 23 October.

Variation across authorities and movements over time

Figures 2 and 3 below show how general and overall reserves vary by authority relative to gross revenue expenditure. General reserves at March 2014 appear to reflect the range that the WAO reported for 2009, 2010 and 2011. Figure 3 shows that overall reserves

show considerable variation and is likely due to large capital projects and change projects in some authorities.

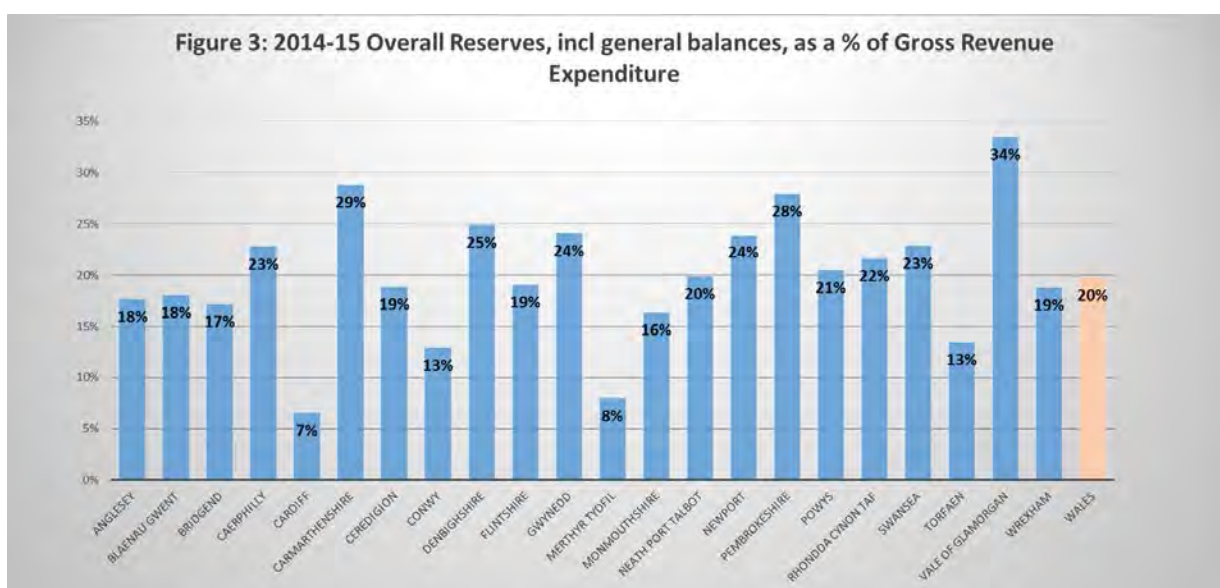
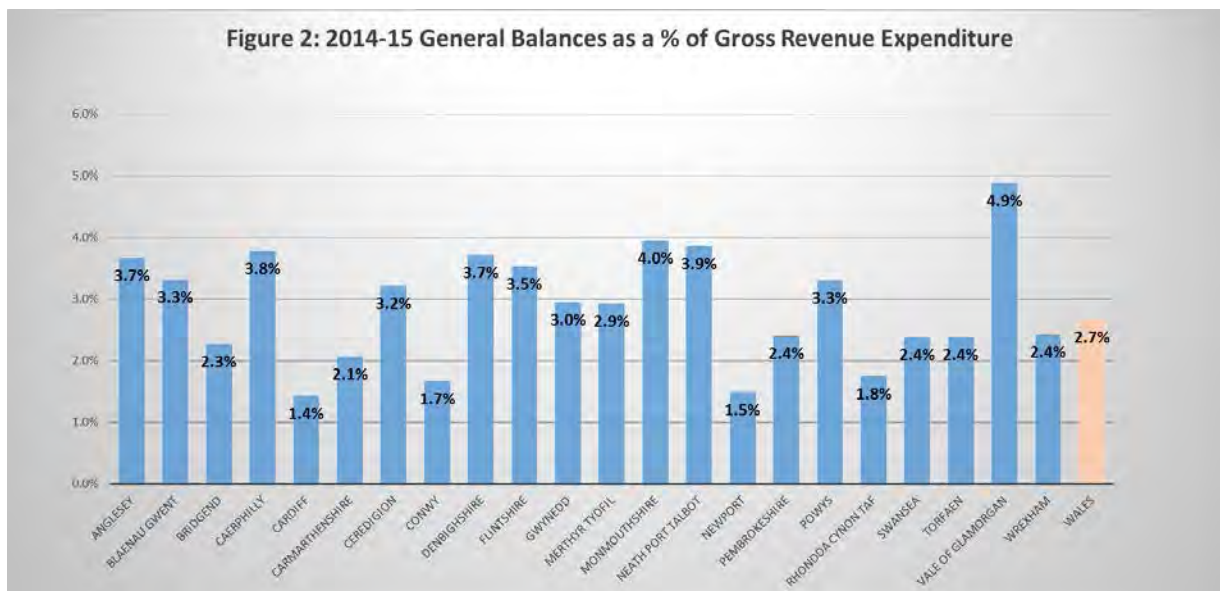
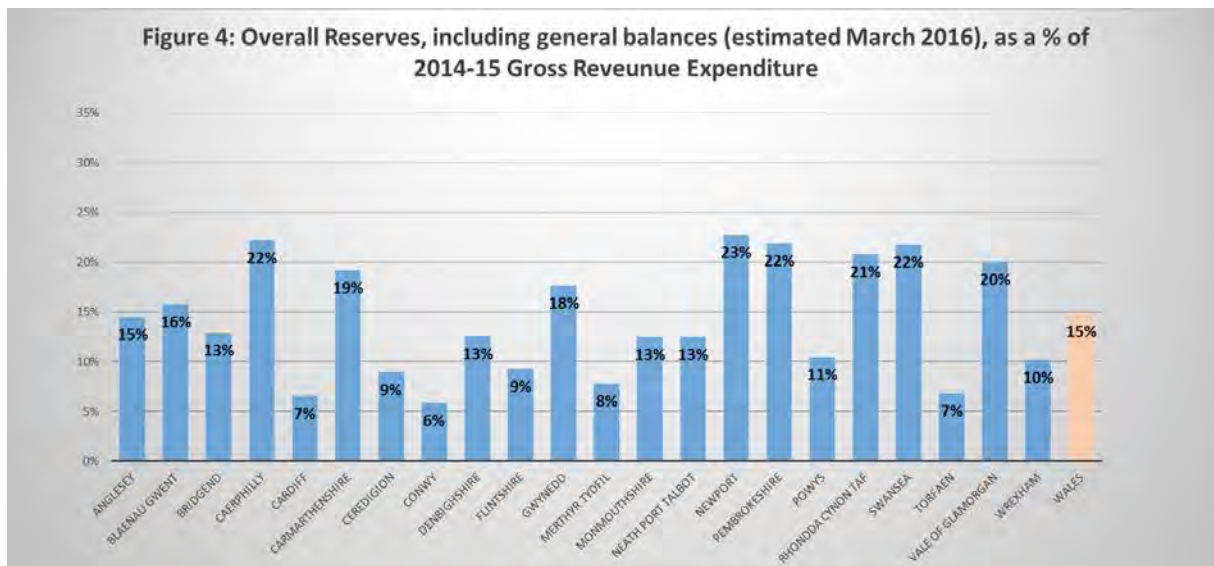


Figure 4 shows variations in overall reserves evening out by the end of 2015-16 and the level of usable reserves is set to fall by £342m. Overall reserves are estimated to fall from 20% of gross revenue expenditure to 15%. These estimates reverse the trend seen in recent years for reserves to increase.

CIPFA have commented upon this in an English context where it has stated that that good performance in realising in-year savings added to the recent reserve build-up. It is not clear how much this applies in Wales other than to note the view of Treasurers that the recent build up is partly a response to austerity and increased risk, and partly a response to supporting Welsh Government initiatives like 21C Schools.



Conclusion

It is important to emphasise the risks which arise when councils decide to draw down reserves to help fund their budgets. The nature of most council services is that they require recurring funding to meet staff and other running costs year after year.

Reserves are a one-off, finite source of funding. They can cover a shortfall in recurring funding for a specific period but, after reserves are exhausted, the underlying shortfall will still be there. This sentiment is echoed in the words of the former Chief Executive of CIPFA, Steve Freer:

"We have to be extremely careful about using one-off reserves to fund shortfalls in recurring funding. Reserves are not a long term solution. At best they buy time to enable service changes to be planned and implemented in an orderly way. In these circumstances it is important that councils explain clearly to the public the actions and implications for services which are expected to follow in the medium and longer term."

The risks to local authority budgets are increasing. Late notifications and in-year reductions to grant funding are increasingly common. Exposure to demand-led spend through, for example, the Council Tax Reduction Scheme also increases risk when the Council tax benefit ceased to operate as a subsidy.

Unlike other public sector bodies councils do not have recourse to central or devolved governments if they overspend. A sound reserves policy is an important response to the statutory obligation to set a balanced budget.

Ultimately, for local authorities, services will need to be reduced to a level which is affordable within the envelope of recurring funding available.