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6 November 2014
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WLGA • CLILC

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Y Pwyllgor Cydraddoldeb, Llywodraeth Leol a Chymunedau
Equality, Local Government and Communities Committee
ELGC(5)-34-17 Papur 1 / Paper 1

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,

Councillor Aaron Shotton
WLGA Spokesperson for Finance and Resources

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WLGA Briefing

Society of Welsh Treasurers

Local Authority Reserves

7 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) from 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 councils' good performance to date in coping with austerity 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 bodies. We tried as much as possible to reconcile the two sources and there is a small residual difference of around £2m.

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

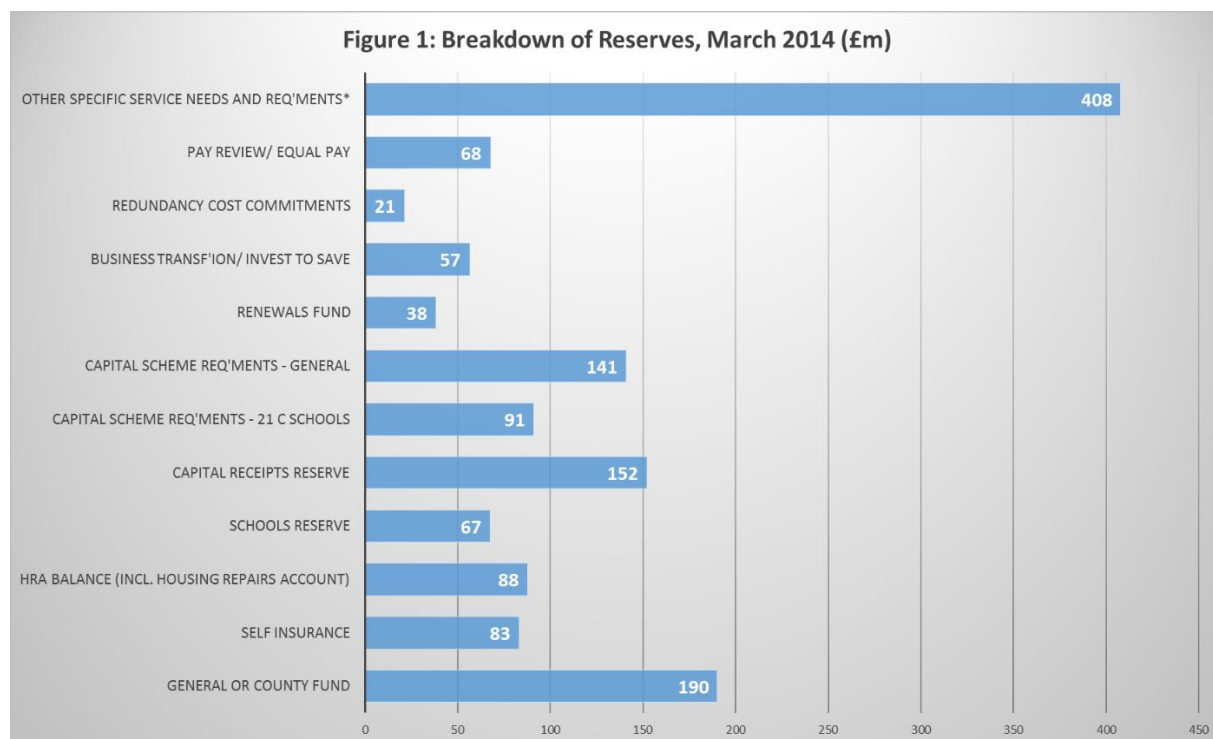
² [Audit Commission \(2012\), Striking a Balance](#)

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

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

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 of 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 Reserves

General funds are working balance to help cushion the impact of uneven cash flows. They are a contingency to cushion the impact of unexpected events or emergencies. Around 14% of the total is held for these purposes and the remainder is for planned purposes and is earmarked.

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 the Code's adoption of IAS 37 *Provisions, Contingent Assets and Liabilities*). These funds account for around 6% of the overall total.

Capital programmes & asset management

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 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. 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.

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 capital 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. In times of economic uncertainty, these estimates may potentially be overstated for the reasons CIPFA recognised in England two years ago. A large fall in reserves may be offset by early in-year savings.

Figure 2: 2014-15 General Reserves as a % of Gross Revenue Expenditure

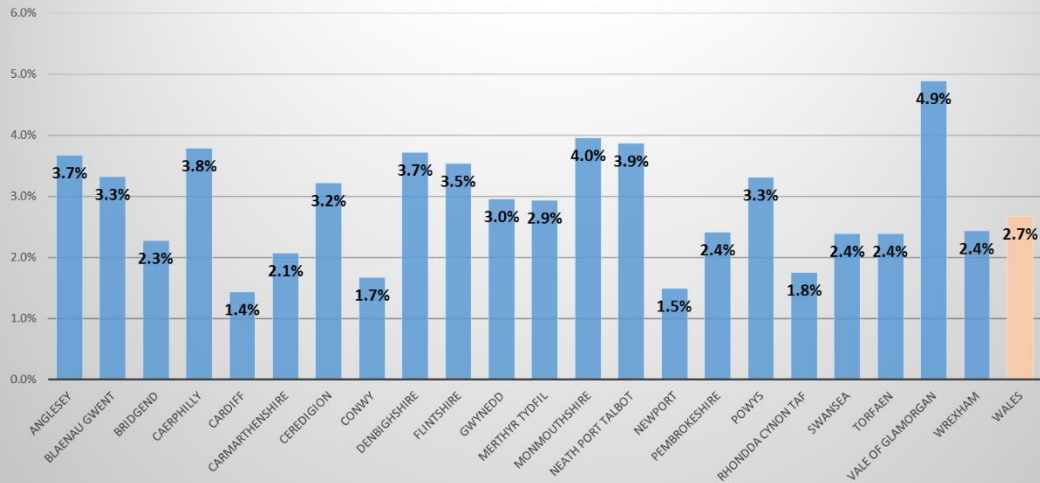


Figure 3: 2014-15 Overall Reserves as a % of Gross Revenue Expenditure

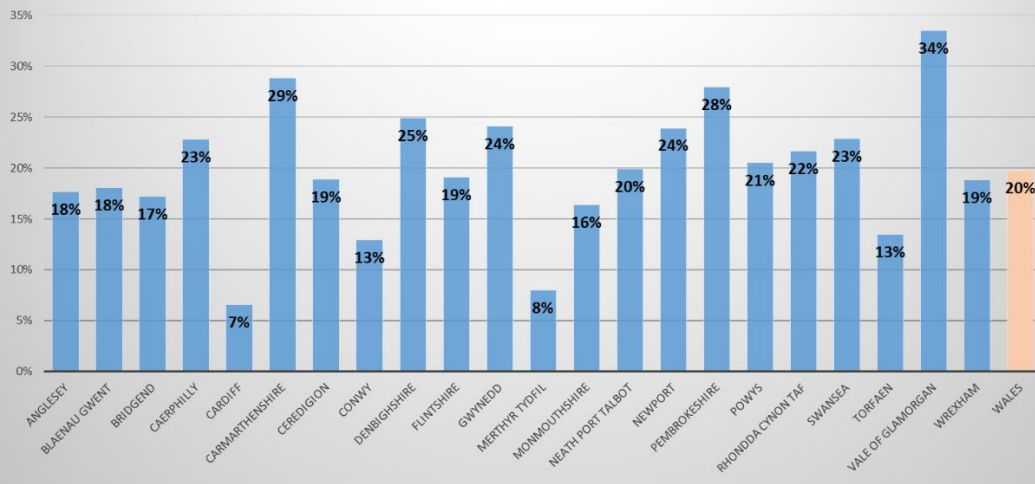
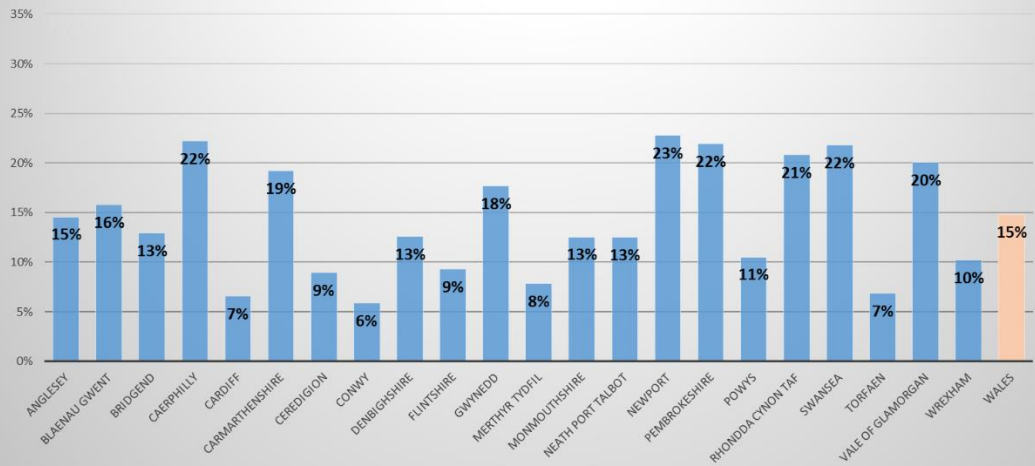


Figure 4: Overall Reserves (estimated March 2016) as a % of 2014-15 Gross Revenue Expenditure



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 as it is not funded as a subsidy.

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

THE GENERAL POWER OF COMPETENCE

Purpose

1. To discuss the General Power of Competence.

Background

2. Launching the General Power of Competence in 2010, the then Community's Secretary Eric Pickles MP colourfully argued that councils would be able to do anything short of trying to "saddle up the horses, arm their citizens and invade France." ¹ Separating the myth from the reality of what the GPC can achieve is crucial not least since evidence suggests that current use of the power in England is limited. The reality is that GPC is playing more of a role as a catalyst especially allowing authorities to use existing powers contained in various Supply of Goods and Services Acts safe in the knowledge that a more risk based approach to provision can ultimately find a legal justification.
3. This has in turn partly accounted for a "new spirit of entrepreneurialism" in England sitting alongside other transformational programmes. The question therefore is whether the powers impact in England has been radical and if so whether its implementation in Wales will signal a similar shift in mind set and innovation in practice?

Issues

4. The General Power of Competence (GPC) is set out in Chapter 1, sections 1 to 6 of the Localism Act. The Government's declared aim is to give local authorities' in England the legal reassurance and confidence to innovate, drive down costs and deliver more efficient services. The GPC gives local authorities the power to do anything that an individual could lawfully do, anywhere, with or without charge, for any purpose, anywhere in the UK or elsewhere. However, the bill also specifies some boundaries to the power which may be imposed by statute, statutory instrument or by an order made by the Secretary of State. Such an order may apply to some or all local authorities and would have to be consulted on before being laid before Parliament. Charging for statutory services and making a profit on charged for services will not be within the GPC and such commercial services will only be able to be provided through a company. In theory the GPC replaces the common law 'ultra vires' rule under

¹ The irony that the power was contained in the Localism Act that actually kept over 140 powers back for the Secretary of State to intervene in local authorities should not however lead to a dismissal of its importance.

which local authorities can only do those things which legislation allows.

5. Although GPC is still relatively new, the Local Government Association (LGA) has said that it has given LAs the confidence to work in new ways and develop new services and partnerships. Equally, councils recognise the constraints on the use of GPC in practice, including:
 - the requirement of a company structure (precluding the use of community interest companies);
 - limitations on charges (discretionary services only, and no surplus permitted); and
 - the time taken to check for pre- and post commencement limitations (whereby a specific power may be identified anyway).
6. A survey by the magazine Local Government Lawyer and Freeth Cartwright (December 2013) found only 6% of councils said GPC had made 'a significant positive difference'. 45% said it made a 'slight' positive difference, and the remaining 49% said it made no difference. A series of case studies are set out in **Appendix A**.
7. Local authorities are able to rely upon the new general power in respect of charging and trading but certain conditions must be met. Local authorities can charge up to full cost recovery for discretionary services - that is those that they are not required to provide to a person, where that person has agreed to the services being provided. Like Section 93 of the Local Government Act 2003 there is a duty, within the Localism Act, to secure that "taking one financial year with another, the income from charges.....does not exceed the cost of provision", i.e. limited to cost recovery.
8. A substantial difference between the previous provisions under the Local Government Act 2003 and the new general power is that whilst section 93 of the 2003 Act only gives a power to charge 'where there is an existing power to provide a service' Section 3 of the Localism Act is not subject to that restriction – because councils can rely upon the general power of competence. The use of charging in this context is subject to certain provisions which are that:
 - a. the service is not one which the authority is required to provide by statute;
 - b. the person has agreed to its provision; and
 - c. (if section 3(2)) and section 93 of the Local Government Act 2003 - "the 2003 Act" – are left out of account), the authority would not otherwise have a power to charge for the service.

Conclusion

9. Experience in England suggests that the use of the power of General Competence remains limited not least because the boundaries of that

legislation are yet to be tested by case law. Whilst it is anticipated that the new general power will reduce the number of challenges and judicial reviews (reducing the effect of the uncertainties created by the LAML judgment) the situation remains unclear in key areas (for those with an appetite for the complexities of this judgement and the application of Teckal the following link provides a useful summary). <http://publicsectorblog.practicallaw.com/teckal-in-the-uk-following-the-laml-decision/>

10. As a result, discussions with Monitoring Officers in Wales suggest some nervousness about initial reliance upon the new general power.
11. Mo Baines who leads on the GPC for APSE has argued further that *"the power must be seen to be in line with ordinary principles of public law. The doctrine of 'ultra vires' remains and local authorities still have a fiduciary duty to local taxpayers not to act in an irresponsible or risky way and therefore, how the new general power is exercised, will be potentially subject to challenge through judicial review. As with previous restrictions on commercial trading through a company APSE would point out that the formation of a company for these specific purposes can be time consuming and cumbersome to set up. Companies should only be considered after a full market assessment, taxation and market analysis. However local authorities could put to great effect better use of charging powers to realize additional income (in a sensible and sensitive way) for example through selling services to the public or private sector to help balance budgets, improve productivity and maximize the use of assets and human resources. The new general power should help to alleviate, for English local authorities, any previous uncertainties about the powers to charge for certain non-statutory services"*.
12. The fact is that in some English authorities the GPC does seem to be playing the role of a 'comfort blanket' for those authorities that have otherwise been very cautious in their approach to innovative solutions, to take forward service transformation plans with charging as part of that service improvement strategy. The issue in Wales is to frame legislation is to learn from the English experience and put in place a legislative approach around the GPC which is more empowering and less subject to legal dispute.
13. The other issue is not to see the GPC as a "silver bullet". Case law remains unclear and as Tim Kerr QC has argued -
 14. *"The usual public law constraints (rationality, relevant considerations, procedural fairness, disregard of irrelevant considerations) will be applied by the courts to exercise of the power of general competence, even though an "individual" in the private sphere is not subject to them. An individual may justify a decision not by appealing to reason but by reference to "the power of intuition, the supra-logic that cuts out all routine processes of thought and leaps straight from problem to answer"*.

15. *Local authorities exercising the new general power would **not** be well advised to emulate such behaviour, nor to rely on intuition when defending any judicial review challenges. The familiar public law constraints are now so firmly embedded in the law that express words would be needed to exclude them and the equation with an "individual" is not itself sufficient to do so: an individual is not invested with heavy statutory responsibilities including stewardship of public funds".*
16. Bearing in mind these caveats it is vital that Welsh councils are given renewed confidence in their powers to continue this work to improve efficiency, for example through joint arrangements, in particular to provide back office and support services which may be defined as 'incidental' in law to their primary functions. Challenges such as climate change and energy security, changes in the make-up of the population, economic change, and technological developments, make it vital councils can take reasonable risks, and provide new services.
17. There is a welcome commitment by Welsh Government in the LG Mergers and Reform Bill to legislate to create a power of general competence for local government. It is anticipated that this would contribute to councils' confidence in their powers to tackle in new ways the challenges their communities face. It is important therefore to gain a full understanding of the limitations but also the considerable possibilities inherent in this approach.

Recommendations

18. Members are asked to:

- a. Consider a national training event on using the General Power of Competence, jointly with the Welsh Government;**
- b. Consider what further steps might be needed to support its use across the Welsh Government and continue to lobby for limited reserve powers in its legislative roll-out.**

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Appendix A

CASE STUDIES

Newark and Sherwood – Small Business Fund

Newark and Sherwood council chief executive Andrew Muter has argued that the "general power of competence provides a new stimulus to be innovative".

In his council it had become clear that small businesses were struggling to access finance for future growth. In response the council set up a £2m fund to address the problem.

The fund is managed by local people with business and financial experience who take individual lending decisions. Councillors set the lending policies and monitor the fund's performance. Since March, the fund has made three loans with more to come.

Essex County Council - Essex Cares.

Essex was the first local authority to set up a traded service focusing on social care. 850 staff moved across from the council to the new organisation, which was set up as an independent company owned by its shareholders. It offers support in the home and the community. It made a profit of £3-3.5 million last year, which was reinvested in the service and has reduced the cost of services for self-funders. It has been very successful from an organisational perspective: absenteeism is down, the turnover of staff has slowed and user satisfaction is now at 99 per cent

Breckland and South Holland – Charging for Services

Breckland has recently used the GPC (in conjunction with other legislation such as the Local Government Act 2003) to provide the legal justification for a scheme to charge for the provision of new and replacement wheeled bins. Both councils see scope for further use of the power. Breckland and South Holland District Councils have a shared management team and see increasing scope to apply the GPC. Breckland's policy to charge for the provision of new and replacement wheeled bins is intended to both help recover the costs of the service and to promote further recycling. They needed to design the scheme so that the council retained ownership of the bins to best manage the waste management stream whilst still securing users agreement to a discretionary service. Both councils have participated in energy switching schemes. There will be increasing scope to apply the GPC as the councils develop radical transformation plans in response to the challenging financial environment and both will continue to foster the entrepreneurial approach from members and officers that this will require.

Sevenoaks District Council - Swanley petrol station and convenience store

The council has been pouring millions of pounds into investment properties in a programme to secure self-sufficiency as RSG ends. Their latest purchase is the second major investment in Swanley.

The property, a garage and convenience store situated on the High Street, was bought for £2.45 million today and is expected to pay for itself within ten years, the council says.

The property is currently let to the Co-Operative Group on a 15 year lease.

The council claim the property will create a steady income, which they will reinvest into council services. Council leader Peter Fleming said the site was in a key position on the town's high street and the council obtained an independent valuation on the property before buying it.

"This opportunity presented as an excellent investment in our bid for self-sufficiency, with a guaranteed long term tenant. The Co-Operative group turned over £9.4 billion last year with a like for like sales growth in their convenience store business of 3.2%."