

**CYNGOR SIR POWYS COUNTY COUNCIL**

**AUDIT COMMITTEE**

**15<sup>th</sup> April 2016**

**REPORT AUTHOR: Professional Lead for Finance**

**SUBJECT: The Holding and Use of Reserves**

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**REPORT FOR: Information and Comment**

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**1. Introduction**

- 1.1 Welsh Government issued a document on January 2016 “Scrutiny of Local Authority Holding and Utilising of Reserves” which was a guidance document for Elected members in their scrutiny role. The document was submitted to this Committee on the 5<sup>th</sup> February, 2016.
- 1.2 Audit Committees should provide assurance about financial control to mitigate key risks and that the Council has effective financial management arrangements.
- 1.3 The Committee requested that they be provided with information to assist in the development of their scrutiny role with regard to Reserves.
- 1.4 This report updates the Committee on the work that has been undertaken in relation to Reserves and provides information to further assist them in scrutinising the holding and use of Reserves by the Authority.
- 1.5 The reserves held by the Authority as at the 31<sup>st</sup> March 2015 as reported in the Statement of Accounts in the Movement in Reserves Statement are attached as Appendix A.

**2. Reserves Policy**

- 2.1 As part of the Cabinet’s overall approach to financial planning within a 3 year time horizon it received a report on the 11<sup>th</sup> December from which they approved a Reserves Policy for the Council. (The Report and Policy are attached)
- 2.2 The Policy establishes the framework within which decisions will be made regarding the level of reserves held by the Council and the purposes for which they will be maintained.

2.3 Reserves are treated as corporate reserves with the exception of the Housing Revenue Account Reserve and Schools (Delegated) Reserves. In 2014 the Council rationalised the reserves held. This was to address a potential risk from reserves designated as ‘service held reserves’, which included both surplus and deficit reserves. These were discontinued and except for a few “truly specific” reserves balances were cleared and transferred to the General Reserve. This has brought greater transparency.

### 3. Financial Indicators for Reserves

3.1 It should be noted that the holding of reserves is a matter for each authority to determine as part of sound financial management. However it is useful to refer to Financial Indicators based on ratios produced by Welsh Government, these indicators provide comparative statistics for Local Authorities and include the following on Reserves:-

- Useable Reserves as % of Gross Revenue Expenditure
- Earmarked Reserves as % of Gross Revenue Expenditure
- General Reserves to Gross Revenue Expenditure (days)

	<b>Powys<sup>1</sup></b>	<b>All Wales Average<sup>1</sup></b>
Usable reserves as % of gross revenue expenditure	16%	17%
Earmarked reserves as % of gross revenue expenditure	8%	12%
General reserves days turnover	13.4 days	10 days

<sup>1</sup>Local Authority Financial Indicators, Wales 2014/15

#### 3.2 Usable reserves as a percentage of gross revenue expenditure

This indicator measures the relationship between an authority’s usable reserves and its annual gross revenue expenditure. This excludes those reserves which are restricted for use by the authorities (i.e. HRA balances, schools balances and capital grants unapplied). Those reserves included in the indicator are:-

- General or Unallocated Reserves
- Capital Receipts Reserves
- Earmarked Reserves.

A high percentage suggests high levels of reserves relative to its expenditure levels. The next two indicators provide an indication of whether this is a result of high levels of reserves being held for general or earmarked purposes, or both.

The average for Wales in 2014/15 was 17%, nine authorities had a % greater than 20%. Powys is 16%.

### **3.3 Earmarked reserves as a percentage of gross revenue expenditure**

This is an indication of reserves increasing proportionately more than gross revenue expenditure or vice versa.

Councils with very high levels of earmarked reserves relative to their spending should review the purposes for which these are held to ensure they are still required. The purpose for holding reserves, particularly where reserves are increasing, should be clearly communicated in presentation to the Council and through the annual accounts.

The average for Wales in 2014/15 was 12%, seven authorities had a % greater than 15%. Powys is 8%.

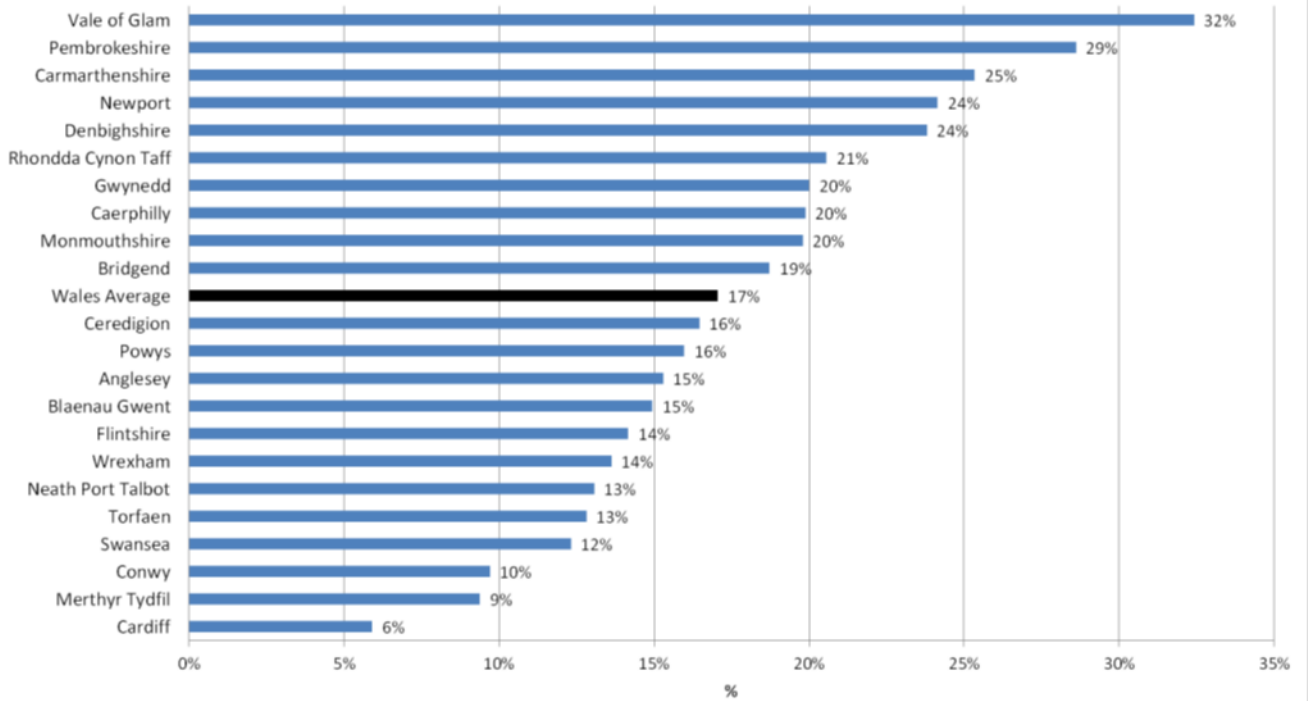
### **3.4 General reserves days' turnover**

This measures the number of days an authority would have of financial cover if it needed to utilise solely general reserves to fund day to day expenditure. Usually this is shown as a percentage but number of days can provide a clearer way of showing the reserve cover. Where the cover is high will indicate that an Authority has a low risk strategy. Conversely a low coverage suggests a higher risk strategy. This may be through choice or due to a lack of other funds.

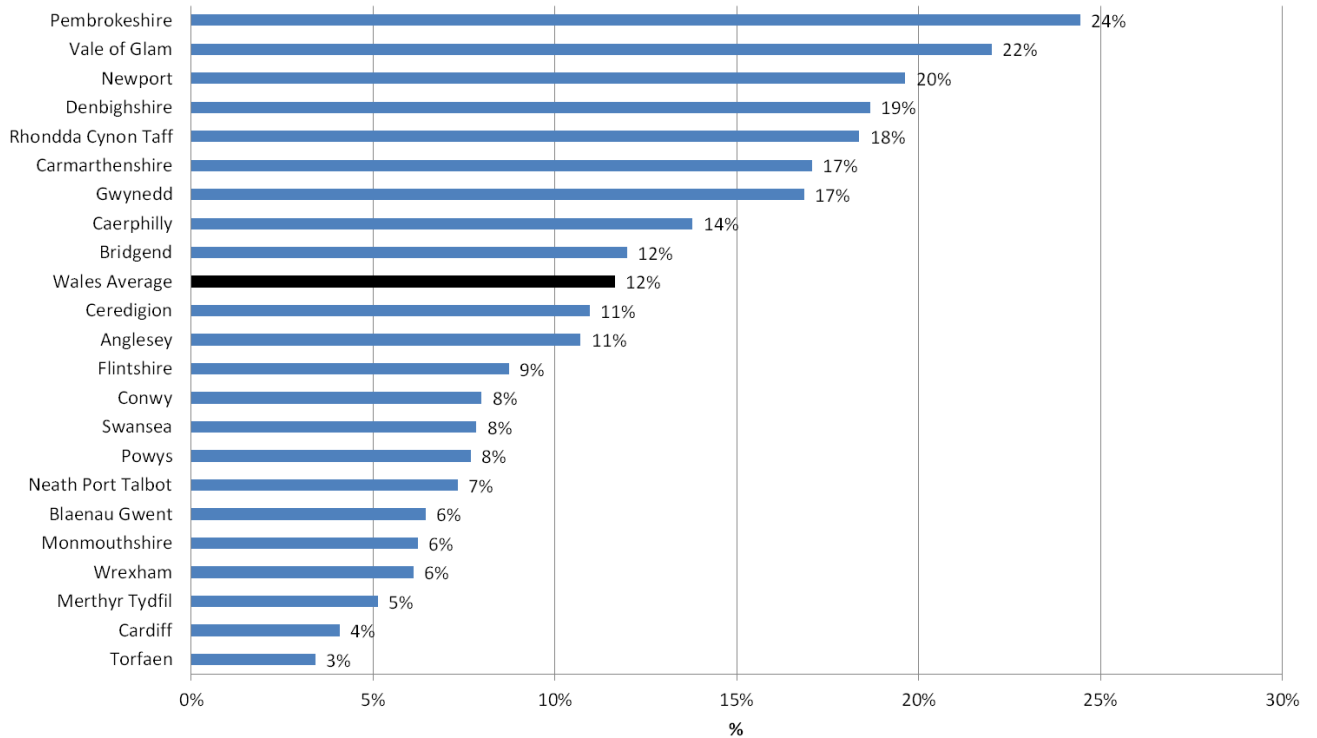
The number of days turnover covered by unallocated reserves for Wales in 2014/15 was 10. Three authorities had more than 15 days turnover cover. Powys is 13.4 days.

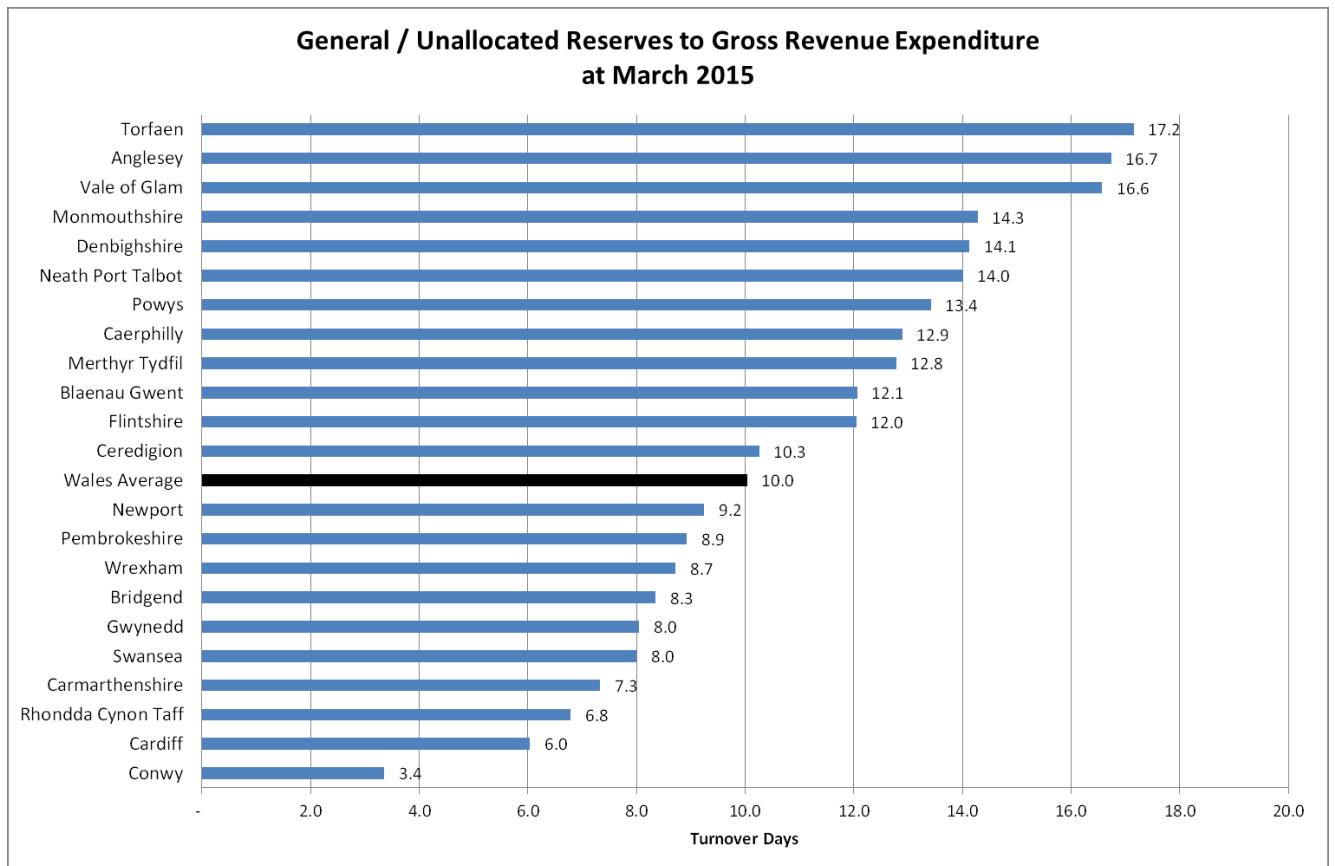
### **3.5 The tables included within the report are provided below.**

**Reserves to Gross Revenue Expenditure  
(excluding HRA, Schools, Unapplied Grants & Group Reserves)  
at March 2015**



**Earmarked Reserves to Gross Revenue Expenditure  
at March 2015**





#### **4. Budget Setting Assessment of Reserves**

4.1 The policy requires that reserves are reviewed at part of the budget setting process and a risk assessment was carried out in January 2016. The following was included within the Budget setting report.

#### **6.0 Reserves**

6.1 *The Reserves Policy was approved by Cabinet on the 11<sup>th</sup> December 2015. The policy establishes a framework within which decisions are made regarding the level of reserves held by the Council and the purposes for which they will be maintained and used.*

6.2 *The use of reserves and the levels at which they are maintained is determined on an annual basis as part of the Councils Budget setting process.*

6.3 *The level of reserves held and their forecast use in 2015/16 is reported monthly to Cabinet as part of the budget monitoring report and the table below reports the opening and projected balance of the reserves held.*

<b>Summary</b>	<b>Reserves 01/04/15 Surplus/ (Deficit)  £'000</b>	<b>Forecast Addition / (Use) of reserves  £'000</b>	<b>Projected 31/3/16 Surplus/ (Deficit)  £'000</b>
<b>General Fund</b>	8,988	21	9,009
<i>Projected Overspend</i>	0	(3,227)	(3,227)
<i>Projected Overspend - Schools Delegated Other</i>	0	(436)	(436)
	<b>8,988</b>	<b>(3,642)</b>	<b>5,346</b>
<b>Ringfenced &amp; Specific Reserves</b>			
<i>Budget Management Reserve</i>	2,019	0	2,019
<i>Specific Reserves</i>	1,516	64	1,580
<i>21st Century Schools Reserve</i>	6,916	(2,040)	4,876
<i>Invest to Save &amp; Corporate Initiatives (inc JE)</i>	9,355	(1,108)	8,247
<i>Insurance Reserve</i>	2,188	0	2,188
<i>Transport &amp; Equipment Funding Reserve</i>	3,028	(3,146)	(118)
<b>Sub-Total</b>	<b>25,022</b>	<b>(6,230)</b>	<b>18,792</b>
<i>Schools Delegated Reserves</i>	3,604	(2,048)	1,556
<i>School Loans &amp; Other Items</i>	(521)	50	(471)
<i>Projected Underspend</i>	0	657	657
<b>Net School Delegated Reserves</b>	<b>3,083</b>	<b>(1,341)</b>	<b>1,742</b>
<b>Total Ringfenced &amp; Specific Reserves</b>	<b>28,105</b>	<b>(7,571)</b>	<b>20,534</b>
<b>Housing Revenue Account</b>	3,832	(3,495)	337
<i>Projected Underspend</i>	0	(88)	(88)
	<b>3,832</b>	<b>(3,583)</b>	<b>249</b>

<b>Total Revenue Reserves</b>	<b>40,925</b>	<b>(14,796)</b>	<b>26,129</b>
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1. *School delegated reserves are split out to show reserves position under budget funding arrangements as some items are not yet recorded in the financial ledgers. This is intended to show the reserves as if the accounts were shut down at the end of this period.*

- 6.4 *A risk based assessment has been carried out to review the level of reserves held and to assess if this level is appropriate when tested against the budget proposals. The strategy identified in last year's budget to replenish these reserves has been subject to review as part of the process.*
- 6.5 *The 2015/16 budget included the replenishment of reserves previously used to fund the wind farm appeals and the temporary use of reserves to balance the budget. In addition a further £500k was set aside to contribute to the General Fund Reserve to assist in increasing the reserve up to the desired level of 3% of net budget.*
- 6.6 *The level of reserves held has been reviewed and due to the increasing financial pressure faced by the Council it is proposed that the replenishment of the reserves is delayed. This can be accommodated without increasing the risk to the Council.*
- 6.7 *The profiling of pressures and savings over the life of the 3 year plan result in an unbalanced budget for 2016/17, in order to balance this year it is proposed that £500k is drawn from the Budget Management Reserve to produce a balanced budget. The Budget Management Reserve was put in place for this purpose and its use is appropriate. It is important to note this is not a use of the general fund reserve.*
- 6.8 *Reserves previously set aside to support the Capital Programme will continue to be used in 2016/17, namely the 21<sup>st</sup> Century Schools Programme and the Transport and Equipment Fund.*

## **5. Monitoring of Reserves**

- 5.1 Reserves are reported monthly within the general budget monitoring, the balances held, budgeted use and forecast use of reserves are all reported in the monthly report to Cabinet.
- 5.2 The Budget Scrutiny Panel are also provided with information on the levels and use of Reserves to enable them to fulfil their scrutiny role.

## **6. Questions to help Elected Members**

- 6.1 A list of questions were included in the Welsh Government Guidance for Elected Members – Scrutiny of Local Authority Holding and Utilising of Reserves. These questions together with answers are provided below.

<b>Recommendation:</b>	<b>Reason for Recommendation:</b>
<p>That the Committee discuss and comment on the report.</p> <p>That the Committee receive a further report updating the reserves position after the accounts for the financial 2015/16 are finalised.</p>	<p>Audit Committees should provide assurance about financial control to mitigate key risks and that the Council has effective financial management arrangements.</p>

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**Background Papers used to prepare Report:**

Welsh Government Guidance for Elected Members – Scrutiny of Local Authority Holding and Utilising of Reserves

Welsh Government – Local Authority Financial Indicators, Wales

Powys' Statement of Accounts 2014/15

Council Budget Papers – 25<sup>th</sup> February 2016



Question	Response
<b>How much is held in reserves</b>	
<p>1. How much does the council have in its reserves – in cash terms and relative to spending?</p> <p>• How do total reserves compare with those held by councils facing similar circumstances?</p>	<p>At 31<sup>st</sup> March 2015, the council held £56.066m in usable reserves. This consists of: -</p> <ul style="list-style-type: none"> <li>• General Balances of £11.007m;</li> <li>• Earmarked Reserves of £26.085m;</li> <li>• HRA Reserves of £3.833m;</li> <li>• Capital Receipts Reserve of £13.804m;</li> <li>• Capital Grants Unapplied of £1.337m.</li> </ul> <p>The Council's gross expenditure in 2014-15 was £299.293m. (Gross expenditure used by WG for Statistical analysis defines this as "total LA expenditure on all services, plus debt financing, but net of any income from sales, fees, charges and other non grant income. Fire and National Park levies are excluded.")</p> <p>Each Council's circumstances are different but this council's percentage of General Balances compared to the net revenue expenditure is higher than average in comparison to other similar Councils within Wales, whilst the level of Reserves is slightly below average.</p> <p>The latest information available shows the level of the Council's general balances are higher than the average of similar Councils within Wales, whilst the level of Reserves is slightly lower. For general balances, the percentage held is 4.7% compared to an average of 3.4%. For reserves, the percentage held is 23.7% compared to an average of 24.7%.</p> <p>Whilst benchmarking provides useful information, each council's circumstances are different and although some financial risks will be the same, others will be specific to that council.</p> <p>Conclusion: The council does carry out comparisons with other councils. The latest information shows that this council holds a higher percentage of general balances and slightly lower percentage of reserves compared to similar Councils. This is consistent with the previous two year's information.</p> <p>This council is maintaining reserves at a prudent level due to inflation and spending pressures from increasing regulation and an ageing population.</p>
<p>2. How have reserves changed in recent years – in cash terms and as a percentage of spending?</p>	<p>Over the last three years, the level of reserves has decreased. Total usable reserves were £62.220m at 31<sup>st</sup> March 2013, £61.662m at 31<sup>st</sup> March 2014 and £56.066m at 31<sup>st</sup> March 2015.</p> <p>The Movement In Reserves Statement provides further breakdown of the reserves and is attached.</p>

<ul style="list-style-type: none"> <li>• How do changes compare with those made by councils facing similar circumstances?</li> </ul>	<p>As noted in response to question 1, the council holds a slightly lower than average percentage held in reserves compared to other similar councils.</p> <p>The pattern of decrease does not compare with other similar County Councils.</p> <p>Conclusion: The amount held in reserves has decreased over the last three years. However, the use of reserves are regularly reported to Members.</p>
<p><b>What reserves are held for</b></p>	
<p>3. What are the risks or future spending plans for which the council is holding reserves?</p>	<p>The council holds reserves so that it can meet unforeseen expenditure and to smooth expenditure across financial years. This is recognised good financial management.</p> <p>The council holds reserves for the following unforeseen expenditure: -</p> <ul style="list-style-type: none"> <li>• Disasters such as severe flooding, hurricane damage, etc. Central Government may provide some grant using the Bellwin rules but the council would be expected to fund some costs in fulfilling its statutory obligations;</li> <li>• Departmental overspends which may arise due to increased demand for services or the inability to achieve planned budget savings;</li> <li>• The anticipated further reductions in government funding;</li> <li>• Invest to Save projects, where the service pays back the reserve over an agreed number of years;</li> <li>• Equal pay claims;</li> <li>• Uninsured risks where it is not economical or practical to purchase external insurance cover</li> <li>• For weaknesses in the level of financial control within the council including the risks associated with companies, owned by the council, and partnerships with other bodies.</li> </ul> <p>The council also holds reserves to smooth expenditure across financial years to meet future spending plans. There are a number of different reasons for smoothing expenditure across financial years and some examples are set out below.</p> <p>One purpose is to maintain or improve service delivery. Examples of monies held in reserves for service delivery are replacement of equipment, investment in ICT, building maintenance, etc.</p> <p>Another reason for holding reserves is where the council has received grant funding in advance of incurring the expenditure and the funding needs to be carried forward to a future financial year to match the expenditure on a project or scheme.</p>

	<p>An example of a reserve held for a specific project is the 21<sup>st</sup> Century Schools reserve.</p> <p>In some cases reserves are held for a specific risk. This is to ensure the council minimises the impact on front line services should it be faced with a financial loss.</p> <p>Conclusion: The council's risks and future spending plans have been considered in setting the level of reserves.</p>
<p>4. What proportion of reserves is:</p> <ul style="list-style-type: none"> <li>• Held to cover short-term financial risk?</li> <li>• Held for medium and long-term risks or spending plans?</li> <li>• Ring-fenced monies that can only be used for specific purposes?</li> <li>• Specific reserves insurance?</li> </ul>	<p>Using the balances at 31<sup>st</sup> March 2015: -</p> <p>20%, this is the General Balances reserve;</p> <p>59%, which consists of earmarked reserves and capital receipts, except schools balances, insurance and specific reserves;</p> <p>12%, which consists of reserves held for HRA and schools balances;</p> <p>9%, specific to service areas and insurance.</p>
<p>5. Are the levels of the council's different reserves appropriate to the risks it faces and the scale of its future spending plans?</p>	<p>The level of each reserve is informed principally by an assessment of the level of financial risk to which the council is exposed and/or an assessment of the role of the reserve in supporting future spending plans.</p> <p>When members consider the budget, the Strategic Director – Resources has undertaken a full risk assessment of all reserves and advises on whether they are appropriate and adequate to the risks they are intended to cover.</p> <p>For example, when a risk decreases, such as with Equal Pay, it is possible to reduce the balance on the reserve as time passes and transfer the funds to the general reserve.</p>
<p>6. How is the need for reserves determined?</p> <ul style="list-style-type: none"> <li>• At what point(s) in the financial year is the need for reserves assessed?</li> <li>• When was the need for reserves last reassessed?</li> </ul>	<p>The Council's Reserves Policy approved by Cabinet in December 2015 sets out the factors that are taken into account in assessing the level of reserves. In summary an assessment is made of the financial commitments and risks that require funding to be aside in order to ensure that the county council is financially sustainable.</p> <p>Members consider the need for reserves when the budget is set in January; as part of monthly financial reporting to Cabinet during the year and when the outturn for the financial year is known. Reserves are subject to continual review.</p> <p>The level of reserves held was last assessed in January 2016 as part of setting the 2016-17 budget and Medium Term Financial Plan. The budget report included a section on Reserves, the level held and proposals for their use.</p>

<b>Contingency funds</b>	
7. Apart from reserves, what, if any, funds does the council hold, corporately or within service budgets, to provide protection against unplanned costs?	<p>The Council approved at budget setting this year to hold a revenue contingency budget of £300k in 2016/17 increasing by £200k in future years</p> <p>Heads of Service are expected to manage their services within the delegated budgets approved by county council. If unplanned costs arise, Heads of Service and budget holders are expected to consider how they mitigate these costs from underspends in other areas of their budget, or by other means.</p>
<b>The relationship between reserves and council tax</b>	
8. Is the interaction between spending, income, movements on reserves and council tax clear to elected members and the public?	<p>The annual budget report makes specific reference to the level of reserves, the possibility of reducing reserves and when necessary the need to increase reserves. This is based on a financial risk assessment taking into account spending, income and council tax.</p> <p>Conclusions: Elected members and the public are given a clear explanation of the interaction between spending, income, movements on reserves and council tax.</p>
<b>Unplanned movements on reserves</b>	
<p>9. In each of the last three years, what difference has there been between the movements on reserves the council expected when setting its budget and the movements that occurred when closing the accounts (as a percentage of spending)?</p> <ul style="list-style-type: none"> <li>• How much of the variation was the result of factors within the council's control?</li> <li>• What can the council learn to improve the accuracy of future budget projections and financial management?</li> <li>• Are any adjustments needed to correct unplanned movements on reserves?</li> </ul>	<p>Please refer to <b>Table 1</b> at the end of the questions which shows the budgeted position on reserves compared with the actual.</p> <p>The amount of control the Council has on reserves depends upon the nature of the reserves.</p> <p>The movement on General Balances between the budget and outturn reflect Member decisions regarding the use of in year underspend. Some of those decisions are made as part of setting the budget and then reflected in monitoring reports for the remainder of the financial year. Other decisions on the use of reserves are actioned through the virement process during the year.</p> <p>The trend for non-schools reserves is to increase between the January budget and the final outturn position in June. There are a number of reasons for this, including changes in the timing of using reserves, Members budget decisions to carry forward underspends from one financial year to the next, increases in underspends and more up to date information regarding the need for provisions.</p> <p>Schools reserves are mainly subject to decisions made by schools in accordance with the local management in schools arrangements and the Council has limited influence over their decisions. Although the Council has robust reporting processes in place, decisions on how schools funds are utilised are made by schools governors.</p>

	<p>When there have been significant movements in the level of reserves, these are planned and Members are involved in the decision making. As financial resources continue to be reduced there is a need to ensure that more emphasis is placed on managing budgets and resources are being used effectively.</p> <p>Members and the Strategic Director – Resources continually review the levels of reserves. Adjustments are made to reserves when risks or circumstances change e.g. as part of the budget setting process.</p>
<p><b>Information for decision making</b></p>	
<p>10. Does advice from the chief finance officer on the adequacy of reserves make clear what reserves are needed and why?</p>	<p>The Council’s Reserves Policy sets out the objective of holding provisions and reserves.</p> <p>The purpose of each reserve held is set out in the Council’s Financial Statements.</p> <p>Any proposed changes to the level of reserves are reported to Cabinet either as part of the budget setting process or within the monthly financial reports.</p>
<p>11. Do elected members need any additional support to make informed decisions on the level of reserves?</p>	<p>Members receive professional advice from the Strategic Director – Resources, as required by the Local Government Act 2003, when making decisions on the adequacy of reserves.</p> <p>In addition, the External Auditor, when reporting on auditing of the Council’s Financial Statements, has the opportunity to raise with members any concerns regarding the adequacy of reserves.</p> <p>To date, members have not identified or requested the need for additional support when making decisions on the level of reserves.</p>

Table 1

<u>Budgeted v Actual Outturn position on Revenue Budget</u>			
	2012/13	2013/14	2014/15
Budgeted Use of Reserves All Services Transfer (From)/ to schools and HRA	£3.319	(£2.761)	(£10.666)
	£0.258	£2.590	(£4.286)
Budgeted Use of Reserves All Services (excl Schools & HRA) Transfer (From)/ to	£3.577	(£5.351)	(£6.379)
Under/(over)spend against Budget All Services schools and HRA	£6.534	£1.941	£3.392
	£4.427	£1.477	£1.373
Under/(over)spend against Budget (excl Schools & HRA)	£2.107	£0.464	£2.019
Net Transfer (from)/to Reserves All Services schools and HRA	£9.853	(£0.820)	(£7.273)
	£4.685	£4.068	(£2.913)
Net Transfer (from)/to Reserves All Services (excl Schools and HRA)	£5.684	(£4.887)	(£4.360)

Budgeted Use of Reserves = Use of reserves budgeted at beginning of year plus changes approved during the year.