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Leighton Andrews AC / AM
Minister for Public Services

Dear Leighton

Date: 13 November 2014

Thank you for your letter dated 23rd October 2014 in respect of the appropriate reporting and use of Local Authority Reserves.

This Council's reserves are explained and reported fully within its annual Statement of Accounts. As your letter indicates, your officials have reviewed the latest 'audited' figures for 2013/14 and this is clearly an important starting point. From the Council's perspective, the audit report that accompanied the Statement of Accounts for this Council included specific references to earmarked reserves and I draw attention to commentary included in that report including:

'we confirmed that the Council considered amounts in earmarked reserves when setting budgets and that its material earmarked reserves are held for specific purposes which are appropriately explained'

Before commenting as requested, on the specifics of reserves held, it is worth highlighting that reserves are a vital part of our financial management and service planning framework. They are based on a local determination in terms of our own specific requirements and the risks inherent in an organisation with an annual gross revenue budget of over £670M. The appropriateness and robustness of all reserves are determined ultimately by our Section 151 officer.

The total value of 'usable' reserves stated in our Statement of Accounts as at 31st March 2014 is £127M. 'Usable' in this context is an accounting term as required by the relevant code of practice that governs the preparation of our annual accounts, it does not mean "available" in terms of supporting any budgetary or other cash requirements that may arise. An extract from the Council's Statement of Accounts is shown below, summarising the £127M total:

31/03/13			31/03/14
£'000			£'000
(11,204)	Council Fund Balance	17.1	(10,282)
(22,548)	Capital, Treasury and Insurance Reserves	17.2	(34,038)
(75,822)	Other Revenue Related Reserves	17.2	(74,918)
(5,379)	Delegated Schools Reserve	17.3	(3,951)
(50)	Usable Capital Receipts Reserve	17.4	(104)
(2,290)	Capital Grant Unapplied Account	17.5	(2,524)
(474)	MGCC Insurance Reserve	17.6	(1,281)
(117,767)	Total Usable Reserves		(127,098)

An explanation of the totals referenced in the summary table is provided below:

- **Council Fund Balance (£10.282M)** – this represents the working balance of the Council, available to fund any unexpected events and / or emergencies. This total represents what the Section 151 Officer and, as subsequently validated by our auditors, feel is a minimum level and equates to just 1.5% of our gross revenue budget (you will note from the information provided to you and your officials by the WLGA that this Council is very much at the lower end (in percentage terms) of Welsh Councils).
- **Capital, Treasury and Insurance Reserves (£34.038M)** – Over £20M of this reserve is already allocated to fund our existing three year capital programme. £11M is our "self insurance" reserve to cover the cost of claims we are likely to receive based on an agreed model of claim and repudiation rates. The balance of just over £2M allows us to smooth the risk associated with volatility in markets affecting the cost of our borrowing.
- **Other Revenue Related Reserves (£74.918M)** – This includes earmarked reserves all set aside for agreed and specific purposes. Significant elements of this total include:
 - Private Finance Initiative (PFI) Equalisation Account (£8.284m) – this represents the differing timing profile of WG support and actual PFI costs the balance of which represents funding required to support the scheme requirements over the life of the scheme and as such will need to be fully allocated to the scheme.
 - Revenue Budget Strategy 2014/15 (£5.216M) – accounting requirements are such that this has to be shown in the total of reserves at year end 2013/14, but it actually represents reserves applied to support the budget strategy in 2014/15 and as such is already fully allocated.
 - Joint Committee Reserve (£2.277M) – the Council's share of reserves / interests in joint committee arrangements. The use of these reserves is determined by the respective Joint Committee.

- Revenue Grant Reserve (£6.321M) – an accounting requirement whereby revenue grants not yet applied to spend must be set aside as a reserve until used for the specific purpose of the grant.
- Financial Management and Human Resources Risk Management Reserve (£33.445M) – this represents the amounts set aside to cover key financial risks and ongoing liabilities to the council including equal pay / value, the costs of voluntary early redundancies linked to service changes, the costs locally associated with the impact of welfare reform and service risks such as Waste Management and Social Care.
- Prior Year Commitments (£9.696M) – these are committed sums required to fund projects carried over from the previous financial year and will be used as the project is subsequently completed.
- Medium Term Financial Planning and Service Transformation (£6.752M) – this is resource set aside as “transitional funding” to support the Council’s medium term financial planning arrangements, essentially recognising that not all Service Changes can deliver full year savings immediately.
- **Delegated Schools Reserve (£3.951M)** – the total value of reserves held by our schools for their own purposes.
- **Useable Capital Receipts Reserve (£0.104M)** – Accounting requirements are such that this must shown separately and represents support allocated to fund our existing three year capital programme.
- **Capital Grant Unapplied Account (£2.524M)** - Again accounting requirements are such that we need to show capital grants received but not yet applied to fund capital expenditure which will be used as the Capital Schemes progress.
- **MGCC Insurance Reserve (£1.281M)** – This council’s requirement to set aside funding for the cost of insurance claims not yet received for events that occurred prior to Local Government Reorganisation in 1996.

The only amount available from the above to directly support the implementation of future years budget strategy work is the Medium Term Financial Planning and Service Transformation (£6.752M). This reserve, as stated previously was set up as a transitional fund and indeed was a key component of agreeing our budget strategy for the current year (2014/15). Transitional funding totalling £5.216M was used in the current year and the level of this reserve annually is determined as part of our in year and year end budget monitoring processes, plus our regular risk assessment undertaken on all reserves. Given the budget gap faced by the Council in 2015/16, I do suspect that we will again have to use some of this reserve to support next year’s budget strategy whilst the impact of our ongoing service change / cuts programme is implemented.

Clearly, use of any reserves to address base budget shortfalls is not a sustainable solution, given their one off nature in terms of funding. In this respect, use of £5.216M of transitional funding in 2014/15 has simply meant that the starting point budget gap in 2015/16 has been inflated to reflect the underlying resource shortfall (£5.216M) brought forward from the previous year. In other words, the greater the value of one off support required in year, the greater the base budget shortfall that needs to be addressed in the following or subsequent years.

Whilst recognising the shortcomings in simply using one off funding to address annual budget shortfalls, we believe the approach we are taking in terms of proactively setting aside transitional funding to support the implementation and base budget impact of service changes represents robust financial management. All of our other earmarked reserves are clearly set aside for specific purposes, which have been fully validated by our auditors. We will also continue to undertake regular and robust risks assessments on the level and classification of reserves held, which again will be scrutinised by the WAO.

In terms of engagement by Members on scrutinising the reserves held by this Council, Members are presented with details as part of the annual budget setting and closure processes at the Council. There are also opportunities to scrutinise and challenge information as part of our quarterly monitoring and reporting arrangements and again when setting the budget.

In conclusion, whilst the total value of reserves as stated in our Statement of Accounts could be considered significant, I hope I have explained that only a very small element of this is truly ‘usable’ to support the revenue budget in the short term. We have proactively identified this usable element as transitional funding to support the implementation of service changes / cuts going forward. This is an approach that I feel represents robust financial management and is a key determining factor in this Council’s ongoing success in terms of financial performance and service delivery, which has seen the WAO year after year supporting the approach we take.

Yours sincerely

A Morgan

Councillor Andrew Morgan
Leader of Rhondda Cynon Taf, County Borough Council