

SUBJECT: Review of Earmarked Reserves

MEETING: Audit Committee

DATE: 30th June 2016

DIVISION/WARDS AFFECTED: All

1. PURPOSE:

- 1.1 To review the level of earmarked reserves held by the Council at the end of 2015/16, the rationale for each reserve and the protocols for using them.

2. RECOMMENDATIONS:

- 2.1 That Audit Committee consider whether the revised protocols for the use of Earmarked reserves contained in the Policy on Earmarked Reserves at Appendix 1 provides appropriate controls to ensure purposeful use of earmarked reserves.
- 2.2 That Audit Committee provides any relevant comments on the protocols prior to their consideration by Cabinet in July.

3. KEY ISSUES:

Background

- 3.1 Cabinet received a review of reserves in 2012, at that time the Council had £18m in earmarked reserves and £6.2 million in general reserve. At the end of 2015/16 the Council had £9.2 million in earmarked reserves and this is expected to reduce to £6.2 million by the end of 2016/17. The general reserve balance has slightly increased to £7 million and is expected to be maintained at this level over the medium term. Replenishment of reserves over this period has been limited to circa £570k from underspends in 2015/16, however there have been opportunities to redistribute reserves as the need for funds such as Single Status reserve expired. The overall use of ear marked reserves has totalled £9 million and has resulted in a 50% reduction in earmarked reserves over the 4 year period, which is a much faster reduction in the use of these reserves than was expected at the last review. The balance on earmarked reserves expected at the end of 2015/16 in the last review was £11.2 million, compared to the actual balance of £9.2 million.
- 3.2 In summary the main uses of the earmarked reserves has included:
- Redundancy costs £1.9 million
 - Invest to redesign £2.2 million, including budget implementation, innovation centre, Adults social care transformation and social care system

- Priority Investment £2.3 million – including Raising education standards and IT technicians for schools £850k, social care £600k, business related £375k, People services strategy £150k,
- IT Investment £1.2 million
- Capital funding to release assets or support capital programme £1.5 million
- Treasury Equalisation - £340k
- Service reserves – Elections and Grass routes £200k

3.3 A further £3 million of earmarked reserves is planned to be used in 2016/17, taking the balance on earmarked reserves to £6.2 million

It is important that all councils undertake periodic reviews of reserves which considers:

- The rationale for keeping each reserve, with reference to the council's future spending plans
- The funds needed
- How long reserves have been held and projections for using them, which should be monitored.
- The protocols for the management of reserves

Definitions of Reserves

3.4 Local Authorities in following proper accounting practices, provide a Movement in Reserves Statement as part of the Local Authority financial statements. This statement presents the movement in the year of reserves of the authority analyses into 'usable' and 'unusable' reserves.

3.5 This report is concerned with Usable reserves rather than Unusable reserves. Unusable reserves arise out of the interaction of legislation and proper accounting practice, either to store revaluation gains or as adjustment accounts to reconcile accounting requirements driven by reporting standards to statutory requirements. These reserves are not resource backed and cannot be used for any other purpose.

3.6 Usable reserves are referred to as cash-backed reserves that can be used to fund future expenditure. As at 31 March 2016 the Council held the following usable reserves:

	31/03/14 £000	31/03/15 £000	31/03/16 £000
General Fund Balance	7,080	6,991	6,989
Schools reserves	988	1,140	1,156
Earmarked Reserves	13,249	10,980	9,269
Total revenue reserves	21,317	19,112	17,415
Capital receipts	8,023	17,629	5,423
Capital Grants unapplied	953	3,130	2,546

Some of these reserves are subject to restrictions on their usage. These include:

Schools Reserve – for use in schools as governed by the Fair Funding Scheme for Financing schools,

Capital Grants Unapplied – this will relate to specific capital projects and will be restricted by the grant terms and conditions

Capital Receipts – this holds the proceeds from the sale of assets and in accordance with regulations these funds can only be used for capital purposes or set aside to repay debt. From April 2016 WG has provided additional flexibilities for Local Authorities to spend 100% of capital receipts from asset sales on the revenue costs of reform projects. Given the pressures on the capital programme, the need to minimise the cost of debt in the revenue account, and the fact that MCC has an earmarked reserve for invest to save projects it is unlikely that capital receipts will be drawn on for this purpose.

General Reserve (Unallocated reserve)

- 3.7 This is a working balance to help cushion the impact of uneven cash flows to avoid unnecessary temporary borrowing and to provide a contingency to cushion the impact of unexpected events or emergencies. There is no prescriptive guidance on minimum or maximum reserves. The authority needs to assess the strategic, operational and financial risks facing it when assessing the adequacy of the general reserve. A WAO report indicated that of the 50% of authorities that did set a minimum level, they typically range between 3 and 5% of net revenue expenditure.
- 3.8 In Monmouthshire a range of between 4 and 6% of net revenue expenditure has been used. Unlike some other Authorities, Monmouthshire has no contingency within the base budget to help cushion the impact of unexpected variations and so relies on its general reserve for this purpose. The Authority's risk register is reviewed when assessing the level of reserves required at budget setting and this is reported to Cabinet and Council. As can be seen in the table above the general reserve has remained fairly constant over the period and at the end of 2015/16 represented 5.1% of net revenue expenditure. Whilst comparisons can be difficult because each authority faces its own particular set of circumstances and risks, some comparisons are published based on the number of day's turnover covered by unallocated reserves. Based on 2014/15 data, the average for Wales was 10 days turnover is covered by unallocated reserves, with a range from 3.4 days to 17.2 days. The figure for Monmouthshire was 14.3 days. The level of the general reserve will continue to be reviewed annually as MTFP work progresses, to ensure it is sufficient for the level and type of risks to which the authority is exposed.

Earmarked reserves

- 3.9 These reserves are a means of building up funds to meet known or predicted requirements. Reviews completed by WAO in 2012 and more recently by the Welsh Government, identified varying levels of disclosure and clarity about the purpose, use and expected timing of use of earmarked reserves as part of the statutory accounts process. In MCC

information is regularly provided throughout the year on earmarked reserves as part of budget forecasting reports, at budget setting stage through reports to Cabinet and Council as well as in the Statement of Accounts.

- 3.10 However, given the last review of reserves was carried out in 2012 and the depletion of reserves in recent years, a further review is considered timely as the Authority faces the next four years of continued austerity. In terms of comparisons with the rest of Wales the average level of earmarked reserves as a percentage of gross revenue expenditure in 2014/15 was 12% with a range of between 3% and 24%. The comparative figure for Monmouthshire was 6% and so at the low end compared to others. Whilst comparisons may be useful, the levels of reserves required in any given authority needs to be assessed against the situation of that Authority, as each authority will be in a different place in relation to the risks they face. The attached review supplements the information provided during the year relating to reserves and focuses on developing clearer protocols for the management of reserves.
- 3.11 As reserves have been used extensively and there is less opportunity to replenish reserve balances as budgets get tighter, earmarked reserves need to work harder to help the Authority through the financial challenges and risks it faces. Reserves should not be used to plug the funding gap and fund on going expenditure, they are needed to help with one off costs to invest and transform services so that they can operate within a reduced financial envelope. Having clearer protocols and responsibility assigned can help to ensure the return from the use of reserves in the future is maximised. The benefits/return from any reserve investment should be monitored as the investment takes place and reviewed once the investment is complete to ensure the expected benefits have been delivered and to gain the learning for future investment decisions.
- 3.12 Given the forecast use of earmarked reserves that was being projected through the 2015/16 budget monitoring reports, Cabinet has already approved some changes in practice to ensure that earmarked reserves remain adequate for the Medium Term Financial Plan:
- Increase workforce planning and redeployment to reduce the need for reserves to cover redundancies
 - Any request for reserve funding must first explore whether existing budgets, or external funding sources can be used for the proposal accepting this may require a change in priorities if existing budgets are used
 - Use of reserves to implement budget savings must use the saving first to repay the reserve
 - IT investment bids will need to be considered in the core capital programme when the IT investment reserve is extinguished, this may necessitate displacing some of the core capital programme allocations depending on the priorities agreed
- 3.13 This has now been incorporated into a more thorough review of the protocols that should be attached to each earmarked reserve and is included in the Policy on Earmarked Reserves in Appendix 1 attached. If action is not taken to slow down the use of earmarked reserves through tighter protocols, consideration will increasingly need to be given to budgeting to replenish reserves or including in the base budget requests that would normally have been funded by reserves, both of which will increase the resource gap in

the MTFP and the need for a greater extent of revenue savings and upheaval to services. As redundancy and pension strain costs have become an on-going feature of today's financial climate, school based redundancies are now contained in the base budget. Including other general redundancy costs as part of the base budget needs to be considered as part of the MTFP.

4. REASON

A review was necessary due to:

Faster than expected use of earmarked reserves over the last 4 year period
Limited opportunities to replenish reserves from in year underspends as budgets get tighter
Limited opportunities to redistribute reserves as various reserves are used up
Risks around the on-going austerity measures, the projected gap in the MTFP and the lack of clarity on the Authority's future business model or longer term financial plan to respond to this, notwithstanding the work recently commenced around 'Future Monmouthshire'.
Huge commitment of capital resources to Future Schools
The need for reserves to work harder
The need to consider some issues as requiring base budgets rather than continued funding from reserves e.g. redundancy costs are unfortunately going to be an ongoing feature of expense for the Authority every year.
To comply with best practice regarding the management and review of earmarked reserves and the Financial Procedure Rules within the Authority's constitution.

5. RESOURCE IMPLICATIONS:

None arising directly from this report. The governance arrangements outlined in this report are designed to ensure that the appropriate resource implications are considered when earmarked reserves usage or replenishment is being considered.

6. SUSTAINABLE DEVELOPMENT AND EQUALITY IMPLICATIONS:

The Future Generations process has been completed and the form is attached at Appendix 2

7. SAFEGUARDING AND CORPORATE PARENTING IMPLICATIONS:

NONE

8. CONSULTEES:

SLT
Monitoring officer
Audit Committee

9. BACKGROUND PAPERS: Nil

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APPENDIX 1 – Policy on Earmarked Reserves

1 Definitions of Reserves

Local Authorities in following proper accounting practices, provide a Movement in Reserves Statement as part of the Local Authority financial statements. This statement presents the movement in the year of reserves of the authority analyses into 'usable' and 'unusable' reserves.

This Policy is concerned with Usable reserves (in particular earmarked reserves) rather than Unusable reserves. Unusable reserves arise out of the interaction of legislation and proper accounting practice, either to store revaluation gains or as adjustment accounts to reconcile accounting requirements driven by reporting standards to statutory requirements. These reserves are not resource backed and cannot be used for any other purpose.

Usable reserves are referred to as cash-backed reserves that can be used to fund future expenditure.

The General Reserve is a working balance to help cushion the impact of uneven cash flows to avoid unnecessary temporary borrowing and to provide a contingency to cushion the impact of unexpected events or emergencies.

However some usable reserves are subject to restrictions on their usage. These include:

Schools Reserve – for use in schools as governed by the Fair Funding Scheme for Financing schools,

Capital Grants Unapplied – this will relate to specific capital projects and will be restricted by the grant terms and conditions

Capital Receipts – this holds the proceeds from the sale of assets and in accordance with regulations these funds can only be used for capital purposes or set aside to repay debt. From April 2016 WG has provided additional flexibilities for Local Authorities to spend 100% of capital receipts from asset sales on the revenue costs of reform projects. Given the pressures on the capital programme, the need to minimise the cost of debt in the revenue account, and the fact that MCC has an earmarked reserve for invest to save projects it is unlikely that capital receipts will be drawn on for this purpose.

Earmarked reserves are a means of building up funds to meet known or predicted requirements and it is the protocols around the management of these reserves that are considered below:

2. Holding Earmarked Reserves

The Council recognises the need to hold and maintain earmarked reserves but also recognises the opportunity cost of holding balances as reserves. For this reason it is important to set out clearly, and regularly review the framework through which reserves

are managed. Management of reserves is a key tool of the Council's overall MTFP and financial resilience over the longer term, key to this is the need to ensure resources are effectively focussed on priorities and risk can be managed.

3. Building Earmarked Reserves

The Head of Finance is authorised to annually review and recommend the appropriate level of earmarked reserves during the budget setting process and at the end of the financial year, taking into account all relevant factors at the time of the review.

Earmarked reserves may be established, as part of setting the budget for a specific purpose to be used in the future. Or they can be created at the end of the financial year if the final outturn allows the creation of a new reserve or the addition to an existing reserve. Responsibility for the approval of adding funds into earmarked reserves is for Cabinet.

4. Using reserves

Earmarked reserves can only be used for the purpose for which they were created. Cabinet, however, can change the use of the earmarked reserves if it so wishes or move funds between reserves. Earmarked reserves must have Cabinet approval before they are used for a specific purpose, unless there is another specific mechanism for approval as outlined in the table below.

Any request for reserve funding must first explore whether existing budgets, or external funding sources can be used for the proposal accepting this may require a change in priorities if existing budget are used

The Cabinet, on the recommendation of the Head of Finance, can eliminate or reduce the funds in the earmarked reserves by adding them to the general reserve.

Earmarked reserves can only be used once and so should not be held to fund on-going expenditure.

The use of reserves is reported to members on a quarterly basis as part of the budget forecasting reports to Cabinet and Select committees.

5. Risk Analysis

Any recommendations on the planned use of reserves needs to take account of the significant risks facing the council. This analysis forms part of the final budget report to Cabinet and Council and includes consideration of the following:

- Future funding gap and continuing low settlements
- Pressures arising from such issues as increasing demand, new and changing legislation, changes in the wider economy and hard to predict events.
- Grant funding streams being reduced or stopped at short notice
- Capital receipts and other income streams not being achieved

- Saving proposals not being delivered and increased demand on services leading to overspends
- Uncertainty in financial markets and the wider economy
- Factors affecting partners working closely with the Council

6. Rationale for keeping each reserve

Earmarked reserves have been set up where there has been a need to set aside resources for a specific future purpose. The purpose of each earmarked reserve is detailed below. Utilisation of these reserves is under the control of the Cabinet and will require approval by it, unless specifically stated otherwise.

Earmarked reserve	Rationale for reserve	Funds needed	Protocol – procedures for management and control of the reserve
Invest to redesign	To fund service redesign to either improve the service, generate income or reduce costs	Investment in projects of an transformational nature	Business case justification of one off investment, must relate to delivery of MTFP and the strategic direction of the Authority as agreed by Council. Must also provide evidence of exploring the use of existing budgets first. Any savings made as a result of the investment must first repay the reserves wherever possible.
IT Transformation reserve	To invest in information technology in support of the organisations outcomes and generation of improved service efficiency, income generation or cost savings.	ICounty strategy Digital by default Big data	Business case submission through the Digital Board
Capital Investment reserve	To finance future capital expenditure	Considered when reviewing the capital MTFP, or to fund unexpected overspends outside of the Authority's control.	Approval to use this funding source is a part of the capital budget and capital MTFP process. Any extraordinary overspends or new schemes requiring funding via this reserve would require Council approval as this would be a change to the capital budget.
Priority Investment reserve	To fund additional one off investment in the Authority's agreed priorities	To address specific issues which are preventing the Authority from achieving its specific priorities. Examples include investment to improve standards in schools, and investment to improve the outcomes for looked after children, and vulnerable adults.	Business case will need to demonstrate the outcomes to be achieved and how the results of the investment will be measured either by quantitative or qualitative KPIs

Redundancy and Pensions Reserve	To meet redundancy costs and commuted payments for early retirements over a maximum of 5 years.	Link with People Strategy, need to minimise call by improved workforce planning	Business case for changes to posts/structures which leads to associated redundancy or pension strain costs needs to demonstrate ongoing saving as a result, to be paid for if possible from savings arising from the restructure.
Insurance and Risk Management reserve	To meet excesses and administration costs on claims against the Council, to provide cover on self-insured risks and contribute to risk management activities	Actuarial valuation of outstanding insurance claims on a periodic basis (normally every 4 years). Annual assessment of changes to claims experience	Insurance cost centre managed through year to minimise impact on reserve. Business case assessment of risk management activity to demonstrate investment reduces claims activity/exposure
Treasury Equalisation reserve	Originally created from rescheduling discounts and premia, intended for use under the concept of prudence to permit a long term view to be taken of treasury decisions.	The Future schools programme more than doubles the existing capital programme and the Authority's funding requirements. Timing of receipts and interest rate forecasts all introduce a risk which is increased in size due to the program	Treasury forecasts as part of the MTFP are provided and assessed for volatility over the medium term. Use of the reserve will form part of the MTFP process to smooth out the impact of cashflows on the revenue account.
Capital Receipt Generation Reserve	Securing capital receipts is a vital element of the Authority's capital investment strategy. Improving the final disposal value by investment, either in the fabric of the asset or by proper disposal expertise ensures the Council obtains the best possible value for surplus assets. Current accounting regulations are such that investing in disposal must be taken against the revenue account and these costs cannot be fully offset against the ultimate capital receipt. The reserve has been established to finance such expenditure.	In accordance with the Asset management plan and County farms strategy.	Estimate of requirement to use this funding mechanism should be made when the approval for selling the asset is sought, so generally captured as part of the Capital budget/MTFP process and approved through Cabinet and Council. Enhancing expenditure needs to demonstrate increased value/return on investment.
Museums Acquisitions Reserve	To receive donations to purchase exhibits for display to general public enhancing the visitor experience to the County	To purchase exhibits	Must demonstrate exhibit is of value to enhancing overall visitor experience, of relevance to the area and enhancing existing collection

Elections Reserve	To fund local elections every 5 years	A constant contribution to the reserve is budgeted every year so that in year 5 there is sufficient funds to pay for the local election	A budget to undertake the local election needs to be estimated as part of the budget process in the year prior to the election taking place. This will enable a budget to be included in the revenue account and funded from reserves in an election year.
Grass Routes Buses Reserve	To replace buses	Originally grant funded and income derived from scheme is ring fenced, so that any balance on the cost centre at the year end is carried forward in this account.	Requirement to fund replacement vehicles or purchase new vehicles needs to be supported by a business case reviewing the options available.
Youth Offending Team	The Authority has lead authority status for administering funds on behalf of other partner organisations in relation to this function.	Under and overspends on the in-year running costs associated with the service are accommodated through holding a balance in reserve.	Protocol for maintaining and using the reserve for this partnership should be included in the agreements in place which govern the operation of the partnership. In the absence of such agreements, recommendations to use or contribute to the reserve should be agreed amongst the partners
Building Control trading reserve	Building Control enforces the Building (Local Authority Charges) Regulations 2010 to ensure building construction is carried out in a safe manner alongside the control of dangerous structures and demolitions. The Regulations state that a "break even" position should be maintained on the chargeable trading element and an earmarked reserve for surpluses and losses be set up and reviewed over a suggested three year rolling basis.	Under and overspends on the in-year running costs associated with the chargeable service are accommodated through holding a balance in reserve.	Use of the reserve to invest in the service would require a business case to demonstrate the benefits to be derived and the specific measures to assess success.
Outdoor education centres trading reserve	The Authority has lead authority status for administering funds on behalf of other partner organisations in relation to this function.	Under and overspends on the in-year running costs associated with the service are accommodated through holding a balance in reserve.	Protocol for maintaining and using the reserve for this partnership should be included in the agreements in place which govern the operation of the partnership. In the absence of such agreements, recommendations to use or contribute to the reserve should be agreed amongst the partners
CYP Maternity cover	An SLA between the Authority and the schools regarding the	Under and overspends on the in-year position are	Expenditure on maternity cover will be monitored through the year, in

	<p>volatility of costs associated with maternity cover requires that any underspends are carried forward in a reserve and overspends funded via the reserve</p>	<p>accommodated through this reserve.</p>	<p>accordance with the SLA between the schools and the Authority. If the reserve is insufficient to cover an overspend position the balance would need to be funded through the revenue account.</p>
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This policy will be subject to periodic review and approval by Cabinet.

SUMMARY POSITION

		2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Account	Cat2(T)	B/F	B/f	C/F	C/F	C/F	C/F
Council Fund							
Council Fund (Authority)		-6,184,035	-6,184,035	-7,061,035	-6,971,903	-6,970,143	-6,970,143
School Balances		-1,024,684	-1,024,684	-772,684	-924,672	-940,802	-940,802
Sub Total		-7,208,718	-7,208,718	-7,833,718	-7,896,574	-7,910,944	-7,910,944
Earmarked Reserves:							
Invest to Redesign							
		-3,563,989	-3,228,444	-2,208,161	-1,483,522	-1,298,155	-639,943
IT Transformation							
		-1,651,656	-1,382,573	-946,845	-639,840	-826,835	-577,974
Insurance and Risk Management							
		-1,717,576	-1,522,862	-1,968,388	-2,250,388	-1,236,396	-1,236,396
Capital Receipt Generation Reserve							
		-518,707	-331,803	-244,246	-460,342	-322,361	-226,985
Treasury Equalisation Reserve							
		-1,124,693	-1,124,693	-1,124,693	-990,024	-990,024	-990,024
Redundancy and Pensions Reserve							
		-735,056	-622,319	-744,243	-599,936	-1,274,256	-681,735
Capital Investment Reserve							
		-2,121,696	-1,592,413	-1,636,445	-1,620,945	-1,264,599	-645,363
Priority Investment Reserve							
		-4,063,902	-3,449,640	-2,468,935	-1,973,294	-1,120,069	-416,155
Service reserves							
YG33	Museums Acquisitions Reserve	-57,303	-59,798	-59,798	-59,798	-56,760	-56,760
YG33	Elections Reserve	-108,183	-33,183	-58,183	-83,183	-108,183	-33,183
YG33	Grass Routes Buses Reserve	-246,502	-259,441	-186,528	-160,615	-139,702	-144,702
Restricted Use Reserves							
		-579,212	-502,443	-550,477	-658,423	-631,287	-631,287
Total Earmarked Reserves							
		-18,040,309	-15,661,446	-13,248,776	-10,980,311	-9,268,628	-6,280,507
TOTAL GENERAL And EARMARKED RESERVES							
		-25,249,028	-22,870,165	-21,082,495	-18,876,885	-17,179,572	-14,191,452