Local Authority Reserves and Unsupported Borrowing – Research paper for Welsh Government

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Summary report

1. Prior to 2004-2005 local government bodies could only borrow when they had a 'credit approval'. However, the Local Government Act 2003(LGA 2003) provided local government bodies with the power to borrow for any purpose relevant to its functions or for the prudent management of its financial affairs.
2. As a consequence of the LGA 2003, the extent of borrowing is controlled by the local government bodies themselves, through the determination of the 'affordable borrowing limit', although the Welsh Government does have reserve powers to impose limits on borrowing. The LGA 2003 therefore provided local government bodies with much more discretion regarding the amount of resources it committed to capital investment and the amount that it committed to current (revenue) expenditure.
3. The duty to determine the level of affordable borrowing places reliance on self-regulation under professional codes of practice, including the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities. This borrowing is commonly referred to as **unsupported borrowing**.
4. In addition to the above, local authorities undertake borrowing and credit arrangements that attract central government support. This borrowing is typically referred to as **supported borrowing**.
5. Alongside their powers to borrow outlined above, local authorities also have the power to hold reserves. Local authorities hold reserves in relation to specific projects (earmarked reserves) and as security against unforeseen expenditure (general reserves). The Local Government accounting Code also requires authorities to establish a number of other reserves, many of which are purely for accounting purposes and are not cash backed and therefore not usable for other purposes.
6. In March 2012, the Welsh Government (Local Government Finance and Public Service Performance Division) commissioned the Wales Audit Office to undertake research into Welsh Local Government's use of unsupported borrowing and their holdings of reserves. In particular, the research was designed to improve the collective understanding of how local authorities manage reserves and use unsupported borrowing to support their financial strategies and to identify any differences of approach across local authorities and identify any areas of notable practice for wider dissemination. More specifically in relation to unsupported borrowing, the review sought to gain an understanding of any reasons why it was not more widely used or barriers to its use.
7. The review was supported by data analysis from published accounts and statistical information, a data return completed by authorities and a series of structured interviews at six authorities in Wales.
8. The conclusions from the review are set out in the detailed report, the main findings are summarised below.

9. Reserves have increased in recent years with a larger proportion held for similar cost pressures and Members and Chief Finance Officers play a key role in determining an appropriate level of reserves.

- Reserves are an important element of local authorities' financial management and Members and Chief Finance Officers have a key role to play in determining their level:
  – appropriate levels of usable reserves is an essential ingredient of local authorities' prudent financial management;
  – legislation establishes the framework within which local authorities maintain financial reserves some of which are unusable; and
  – the Chief Finance Officer plays a key professional role in advising Members on determining an appropriate level of reserves.
- Amounts held in reserves vary and have increased over recent years with a large proportion being held for similar cost pressures although the expectation is that these reserves will reduce in the short term:
  – whilst the level of general reserves has remained constant, the level of earmarked reserves has increased by £202 million from 31 March 2009 to 31 March 2011;
  – local authorities hold similar types of earmarked reserves which reflect similar cost pressures and financial constraints;
  – over 80 per cent of local authorities in Wales are expecting levels of earmarked reserves to reduce over the next few years; and
  – the level of general fund and earmarked reserves held by local authorities varies significantly.
- Authorities generally have processes and procedures in place for managing reserves but they vary in terms of detail:
  – fifty per cent of local authorities in Wales set minimum reserve levels in respect of their Council Fund balances;
  – the majority of local authorities have policies and procedures in respect of general and earmarked reserves with 70 per cent having specific protocols on earmarked reserves as recommended by CIPFA's LAAP Bulletin 77; and
  – improvements have been made to risk assessment processes and better links are being made to the developing Medium Term Financial Plans.
- Whilst there has been improvement in recent years, there is scope for improved reporting on the management of reserves during the financial cycle and in financial statements:
  – financial statements are often lengthy and highly detailed which can make finding and interpreting information on reserves a challenge;
  – the level of information recorded in financial statements to explain specific earmarked reserves varies; and

- some Authorities report on reserves across the whole financial reporting cycle.

The use of unsupported borrowing has generally increased and been used for a variety of schemes although affordability remains the key challenge

- The flexibility provided by the use of unsupported borrowing has been widely supported by Chief Finance Officers in Wales but affordability remains the key challenge:
  - legislation sets out the framework within which local authorities can make use of unsupported borrowing;
  - unsupported borrowing is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities;
  - the flexibility provided by the use of unsupported borrowing has been widely supported by Chief Finance Officers in Wales; and
  - affordability remains the clear challenge facing local authorities in their use of unsupported borrowing.
- Unsupported borrowing has increased significantly in 2011-12 and the trend is set to continue in 2012-13:
  - the level of unsupported borrowing has increased significantly in 2011-12;
  - the upward trend in unsupported borrowing is set to continue in 2012-13; and
  - whilst the level of unsupported borrowing varies significantly between local authorities in Wales, there are many factors that contribute to the differences.
- Unsupported borrowing has been used for a wide variety of schemes, primarily financed from future revenue savings:
  - unsupported borrowing for a variety of purposes and has been primarily financed from savings and revenue sources; and
  - procedures are in place to manage and report information in relation to unsupported borrowing and links are developing with longer term capital planning.

Detailed report

1. Reserves have increased in recent years with a large proportion held for similar cost pressures and Members and Chief Finance Officers play a key role in determining an appropriate level of reserves

Reserves are an important element of local authorities' financial management and Members and Chief Finance Officers have a key role to play in determining their level

Appropriate levels of usable reserves is an essential ingredient of local authorities' prudent financial management

1.1. Usable reserves are sums of money accumulated by local authorities to help them manage future costs that are:

- Predictable or planned – such as asset purchases or redundancies ('earmarked' reserves); or
- Unpredictable – such as increased demand for services or reduced levels of income (general reserves).

1.2. Local authorities can utilise reserves to help them to balance their budgets where savings plans do not achieve expected results or income is less than anticipated. Local authorities could also increase reserves if income levels are higher than expected, or spending is lower than expected or predicted. Financing recurrent expenditure from reserves is not normally regarded as prudent. Having a prudent level of reserves is a key element of financial stability although no minimum or maximum levels are specified.

Legislation establishes the framework within which local authorities maintain financial reserves some of which are unusable

1.3. Sections 32 and 43 of the Local Government Finance Act 1992 require Unitary Authorities in Wales to have regard to the level of reserves needed to meet estimated spending when calculating the budget requirement. Section 25 of the Local Government Act 2003 (LGA2003) requires:

- the Chief Finance Officer (CFO) to report to members on the budget, including on the adequacy of reserves; and
- members to have regard to the CFO's report in making their decisions.

1.4. Section 26 of the LGA2003 gives the Secretary of State / Welsh Ministers power to determine minimum reserves for local authorities.

1.5. Further details as to these legislative requirements are set out in Appendix 1 to this report.

1.6. Usable reserves are cash backed and can be used to fund future expenditure. Unusable reserves are established for specific legal or accounting purposes and cannot be used to fund future expenditure. Local Authority accounting requirements are complex and it is important to understand the position with respect to all reserves, as many of the items included on the balance sheets are unusable reserves recording unrealised gains and losses or differences between charges required by proper accounting practices and those required by legislation.

1.7. Exhibit 1 below provides a list of all usable reserves and unusable reserves which feature on local authority the balance sheets.

Exhibit 1 –local authority usable and unusable reserves

Usable reserves	Unusable reserves
Council Fund (general reserves)	Revaluation Reserve (previously Fixed Asset Restatement Account)
Earmarked	Capital Adjustment Account (previously Capital Financing Account/Reserve)
Schools	Financial Instruments Adjustment Account
HRA	Available for sale financial instruments reserve
Capital receipts	Pensions reserve
Capital Grants unapplied	Unequal back pay account

1.8. Exhibit 2 shows an extract from a typical local authority balance sheet disclosing the various reserves along with a description of their purpose.

Exhibit 2 - 'Financed By' section of local authority balance sheet

Council Fund	7,158
Earmarked Reserves	22,474
Capital Receipts Reserve	11,607
Capital Grants Unapplied	389
Revaluation Reserve	105,852
Pensions Reserve	(226,110)
Capital Adjustment Account	251,809
Financial Instruments Adjustment Account	(5,936)
Total Reserves	**167,243**

Usable
These reserves are a means of building up funds, to meet known or predicted requirements; earmarked reserves are accounted for separately but remain legally part of the general fund.

Usable
This reserve holds the proceeds from the sale of assets, and can only be used for capital purposes in accordance with regulations.

Usable
This is a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing and forms a contingency to cushion the impact of unexpected events or emergencies

Usable
This is a reserve for holding grant funding that has been received and recognised in the Comprehensive Income and Expenditure Statement (CIES) as the conditions set by the grant funding body have been met but the expenditure to be funded by that grant has not yet been incurred.

Unusable
This is a 'proper practices' reserve that records unrealised gains in the value of fixed assets. The reserve increases when assets are revalued upwards, and decreases as assets are depreciated or when assets are revalued downwards or disposed of.

Unusable
A specific accounting mechanism used to reconcile the different rates at which gains and losses (such as premiums on the early repayment of debt) are recognised under proper accounting practice and are required by statute to be met from the general fund.

Unusable
A specific accounting mechanism used to reconcile the different rates at which assets are depreciated under proper accounting practice and are financed through the capital controls system.

Unusable
A specific accounting mechanism used to reconcile the payments made for the year to various statutory pension schemes in accordance with those schemes' requirements and the net change in the authority's recognised liability under IAS19 *Employee Benefits*, for the same period. An appropriation is made to or from the pensions reserve to ensure that the charge to the general fund reflects the amount that needs to be raised in taxation.

1.9. Further details of usable reserves can be seen in Appendix 2(i) and unusable reserves Appendix 2(ii). This review has primarily focused on general and earmarked reserves (excluding school balances). Definitions are provided in Appendix 2(i).

The Chief Finance Officer plays a key professional role in advising Members on determining an appropriate level of reserves

1.10. Authorities decide the level of reserves to hold guided by their CFO. The decisions should balance strategic, operational and financial risks and be aligned with the professional view of the CFO.

1.11. For Members to form their views, CFOs need to take account of the risks facing the Authority as referred to above along with its financial position, known commitments, spending plans and liabilities including such matters such as:

- internal and external risks to the organisation;

- assumptions underpinning the annual budget;
- financial management arrangements;
- cash flow requirements;
- inflation and interest rates;
- the level and timing of capital receipts;
- demand led pressures;
- planned efficiency / savings targets; and
- general financial climate.

1.12. These represent a combination of external and internal factors which are best assessed in the context of both the budget for any particular year and the medium-term financial plan.

Amounts held in reserves vary and have increased over recent years with a large proportion being held for similar cost pressures although the expectation is that these reserves will reduce in the short term

Whilst the level of general reserves has remained constant, the level of earmarked reserves has increased by £202 million from 31 March 2009 to 31 March 2011

1.13. At 31 March 2011, local authorities in Wales held earmarked reserves of £766 million and general fund balances of £155 million. The earmarked reserve balances increased by 35 per cent between 31 March 2009 and 31 March 2011. This equated to an 11 per cent increase in the period from 2009 to 2010 and a 22 per cent increase in the period from 2010 to 2011. All other usable reserves (including general reserves) remained fairly constant over the period. Exhibit 3 below shows the level of usable reserves for Welsh local authorities over the three year period.

Exhibit 3 – Usable reserves held by local authorities in Wales from 31 March 2009 to 31 March 2011

Usable reserves	31 March 2009	31 March 2010	31 March 2011
General reserves	£157m	£152m	£155m
Earmarked	£574m	£635m	£776m
School balances	£74m	£70m	£74m
HRA	£85m	£96m	£91m
Capital receipts	£159m	£162m	£180m
Capital Grants unapplied	£47m	£61m	£69m

Usable reserves	31 March 2009	31 March 2010	31 March 2011
Total usable reserves	£1,096m	£1,176m	£1,345m

1.14. In England, earmarked reserves grew by eight per cent from 2010 to 2011 to £10.5 billion and general reserves grew by eight per cent to £4.2 billion over the same period. The percentage increases in Wales over the same period were 22 per cent for earmarked and two per cent for general reserves. Whilst it is not possible to be certain about the reasons for the difference, a significant factor is likely to be that the spending reductions applied to Local Government in England were front loaded to the first year of the CSR period.

Local authorities hold similar types of earmarked reserves which reflect similar cost pressures and financial constraints

1.15. Our review highlighted a number of factors leading to an increase in earmarked reserves. There were specific increases attributable to:

- Capital reserves – authorities continue to set monies aside to meet capital commitments, including match funding the 21st Century schools programme. Local authorities have made considerable efforts to maintain their capital programme by building up earmarked reserves to finance the gap left by a significant decrease in capital funding. Authorities are forecasting a 28 per cent reduction on capital programmes in 2012-13 (source: Wales Audit Office – *A Picture of Public Services: The key financial challenges facing Welsh public services) and further reductions in following years*.
- PFI reserves - these reserves have continued to build to match PFI funding and unitary charge payments over the period of the contract. Central funding in respect of PFI schemes is usually skewed in favour of the early years of the schemes. Monies are therefore set aside in an earmarked reserve to meet contractual payments in the latter years of the scheme where the contractual payments outweigh the central funding streams.
- Insurance reserves – monies set aside to meet internal insurance claims which are funding from the authorities own resources.
- Single status reserves/equal pay reserves – a number of Authorities are still in the process of implementing single status agreements and funds are therefore set aside to meet additional cost obligations that are likely to arise once the schemes are implemented.

1.16. Increases in earmarked reserves for the above areas account for over 40 per cent of the £202 million increase in earmarked reserves over the period from 2009-2011.

1.17. In addition to the above, a review of the financial statements of authorities and discussions with officers indicate a number of other general factors have been attributed to the increase in earmarked reserves:

- Changes in demographics which have put further pressure on demand led services – reserves have been built up to mitigate potential over spending.

- Windfall gains, eg. VAT refunds and transfer of housing revenue account balances on stock transfers. In many cases, windfall gains have been used to establish reserves to manage areas such as transformational change programmes, various corporate development initiatives and the risks around delivery of efficiency programmes.
- Responding to policy initiatives – reserves held to meet known/unknown implications of policy change, e.g. Welfare Reform.

1.18. Given that authorities are facing very similar national pressures there was a great deal of commonality in terms of the type of earmarked reserves held. Exhibit 4 identifies the common types and levels of earmarked reserves held by authorities in Wales as at 31 March 2011. These account for approximately 60 per cent of the earmarked reserves held. This analysis has been based on our review of the narrative descriptors provided in the local authority financial statements for the year ended 31 March and is only an indication as the wording and level of detail to describe earmarked reserves varies (see paragraph 1.42.).

Exhibit 4 – typical earmarked reserves held by local authorities in Wales

Typical earmarked reserves held by local authorities in Wales	Value of typical earmarked reserve for local authorities in Wales as at 31 March 2011
Capital schemes	£102m
Single status	£87m
Self insurance	£85m
Business change / invest to save / redundancy	£76m
PFI contracts	£73m
Repairs and renewals	£24m

Over 80 per cent of local authorities in Wales are expecting levels of earmarked reserves to reduce over the next few years

1.19. We asked authorities what they were anticipating the outlook for the level of their reserves to be in the financial year ending March 2012 (2011-12). The vast majority (80 per cent) indicated that their level of earmarked reserves would fall. Estimated forecasts provided by local authority finance officers identified that this would fall in the region of between five per cent and 10 per cent.

1.20. In conducting interviews with a number of CFOs, we asked about their projected reserve position over the medium term. CFOs indicated that their reserves (specifically earmarked) would fall in the medium term which, in some cases, was supported by figures included in the medium term financial plan.

1.21. In respect of general reserves, 90 per cent of authorities indicated that these would fall by 31 March 2012. Similar to earmarked reserves, forecasts identified that this would fall by around five per cent. Medium-term projections identified that these would remain either at similar levels or see a marginal fall in their overall level from March 2012 onwards.

1.22. Given the financial pressures facing Local Government over the coming years and the anticipated resolution of the outstanding single status agreements, a reduction in the levels of reserves held would be anticipated as indicated by CFOs.

The level of general fund and earmarked reserves held by local authorities varies significantly

1.23. The previous sections have highlighted a number of themes in relation to the level of reserves held by local authorities particularly in respect of:

- levels of reserves held by local authorities being a matter judgement for Members based on professional advice and guidance of the CFO;
- significant financial pressures on the horizon have led to increases in the levels of general reserves; and
- there is a great deal of commonality between Authorities in terms of the purposes for which earmarked reserves are established.

1.24. Comparisons of the general and earmarked reserve figures (excluding school balances) published in the accounts of Welsh local authorities highlight a number of points:

- Although general reserves have remained fairly constant in total from 2009 to 2011 (see Exhibit 3), there is variation at individual authority level both in terms of the value (Exhibit 5) and value relative to gross revenue expenditure *(source Welsh Government RO statistics)* (Exhibit 6).
- Earmarked reserves (excluding school balances) have increased significantly in total from 2009 to 2011 by £202 million (see Exhibit 3). For the majority of councils individually, the levels of earmarked reserves have also generally increased both in terms of value (see Exhibit 7) and relative to gross revenue expenditure *(source Welsh Government RO statistics)* (Exhibit 8).
- Some Councils routinely operate with relatively low levels of reserves compared to others.

Exhibit 5 – general reserves for local authorities in Wales [1]

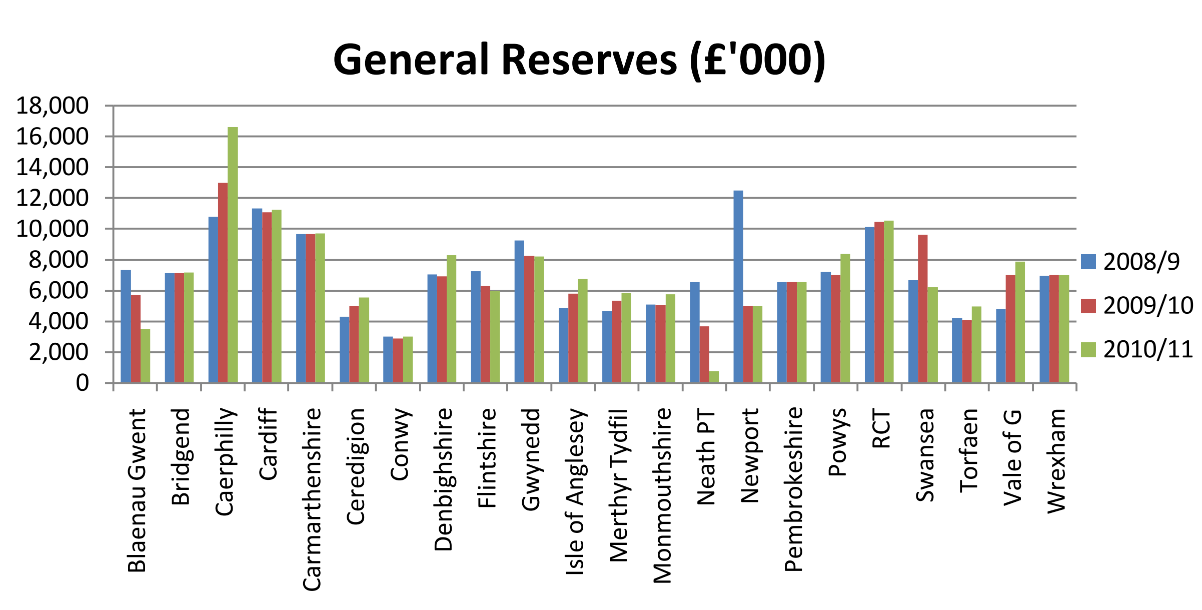
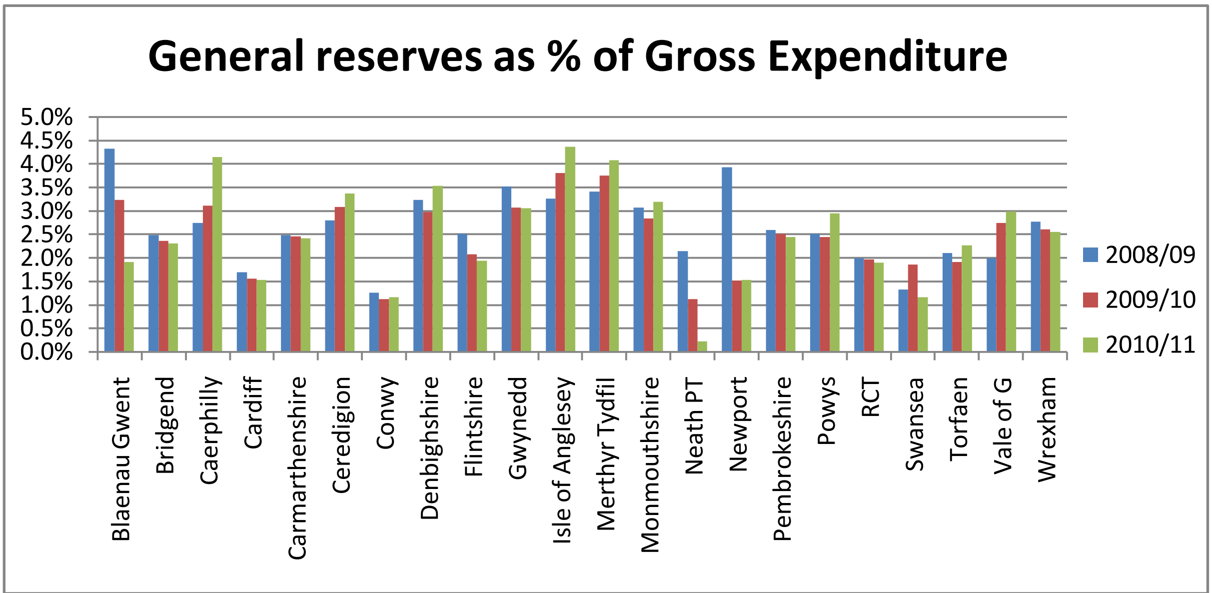


Exhibit 6 - General reserves as a percentage of Gross Expenditure



[1] The figures show for Neath Port Talbot in Exhibits 5, 6 and 9 for 2010-11, are as per the statement of accounts. A transfer of £3.2 million was made from general reserves to a provision in the 2010-11 accounts relating to early retirement/voluntary severance agreements taking place in 2011-12. The general reserve was restored to its former level on 1 April 2011.

Exhibit 7 – earmarked reserves for local authorities in Wales

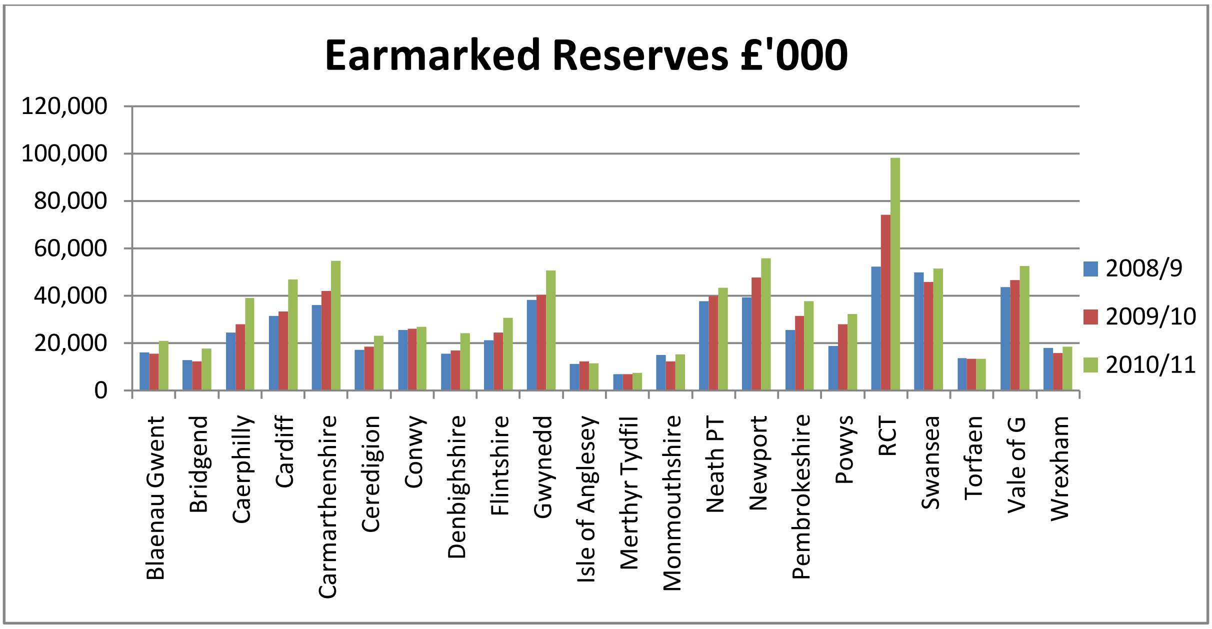
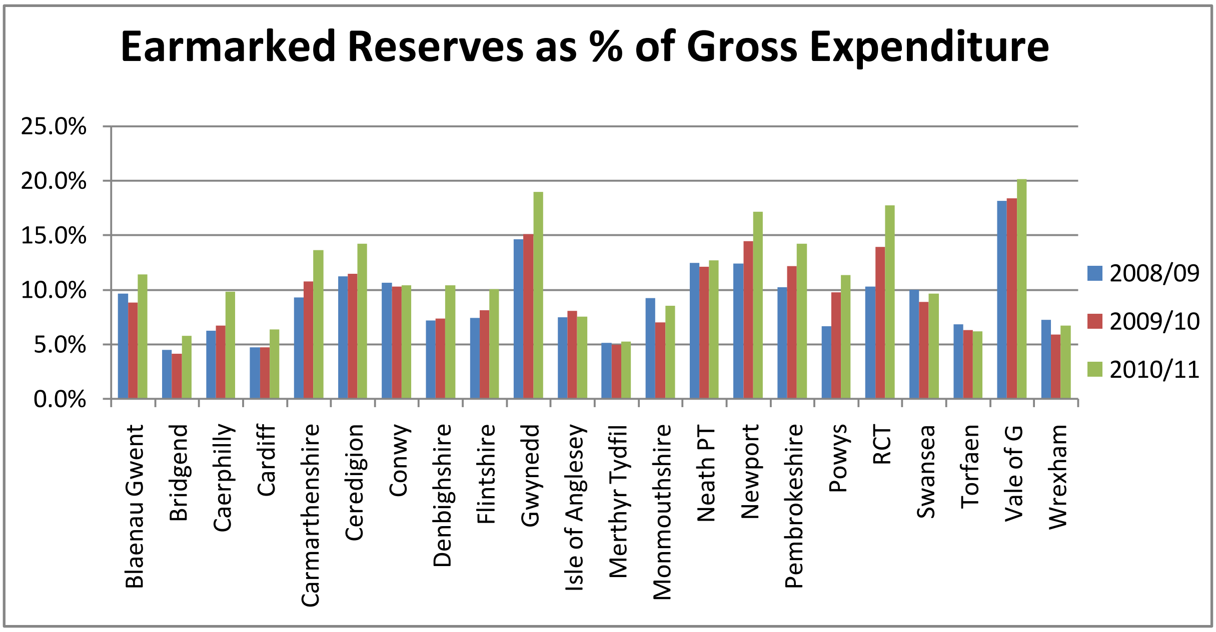


Exhibit 8 – Earmarked reserves as a percentage of Gross Expenditure



1.25. Exhibit 9 details the ranges of local authority general fund and earmarked reserves over the period from 2008-09 to 2010-11. It is evident that the range of general and earmarked reserves varies significant between authorities both in terms of value and the value as a percentage of gross revenue expenditure.

Exhibit 9 – range of general and earmarked reserves across local authorities in Wales

	Range - 2008/09	Range - 2009/10	Range 2010/11
General reserves	£3m to £12m	£3m to £13m	£1m to £16m
General reserves as a % of GRE	1.3% to 4.3%	1.1% to 3.8%	0.2% to 4.4%
Earmarked reserves	£7m to £52m	£7m to 74m	£7m to £98m
Earmarked as a % of GRE	4.5% to 18.2%	3.8% to 18.4%	5.3% to 20.1%

Authorities generally have processes and procedures in place for managing reserves but they vary in terms of detail

Fifty per cent of local authorities in Wales set minimum reserve levels in respect of their Council Fund balances

1.26. A number of authorities set a minimum level for their general fund balance. Those authorities who do so tell us that, whilst only a guide, it helps in terms of reporting levels of general fund balances to members and is only used as a benchmark indicator.

1.27. The majority of authorities who set minimum levels, do so in percentage terms. Typically, ranges fall between three and five per cent of Net Revenue Expenditure (NRE), although some are set at levels of seven per cent of NRE or two per cent of Gross Revenue Expenditure (GRE). Some local authorities set at absolute levels, eg £6 million and £10 million. In respect of establishing minimum reserve levels:

- all authorities who set minimum levels report the levels to full Council;
- the factors used to determine minimum levels are strategic, operational and financial risks, the economic climate, cost pressure, policy initiatives and the level of short-term working balances; and
- local authorities reviewed their minimum levels within a given financial year.

1.28. Local authorities who did not set minimum levels of general fund balances claimed to assess their general fund reserve position on an annual basis and report specifically in the context of their adequacy.

1.29. We would not propose that a minimum level of reserve is set for local authorities across Wales and would wholly support the comment made by CIPFA in LAAP Bulletin 77 – Local Authority Reserves and balances (November 2008) which quotes:

"Imposing a generally applicable minimum level would also run counter to the promotion of local autonomy and would conflict with the financial freedoms introduced for English and Welsh local authorities in the Local Government Act 2003 and for Scottish authorities in the Local Government in Scotland Act 2003. Nor is it considered appropriate or practical for CIPFA, or other external agencies, to give prescriptive guidance on the minimum (or maximum) level of reserves required, either as an absolute amount or a percentage of budget."

1.30. The establishment of a minimum level of reserves is no different from establishing actual levels of reserves and in our view should remain firmly in the domain of Members on advice from CFOs. Members should establish minimum levels on an annually based on the strategic, operational and financial risks facing the authority on advice from the CFO.

The majority of local authorities have policies and procedures in respect of general and earmarked reserves with 70 per cent having specific protocols on earmarked reserves as recommended by the Chartered Institute of Public Finance and Accountancy's LAAP Bulletin 77

1.31. Our findings have identified that policies, procedures and protocols exist in many different formats across authorities. Some have formal policies, others have approaches included within financial procedures and some are embedded within the constitution. Authorities have disclosed that, in general, these documents largely contain the purposes for which reserves are held, when reviews take place and approaches to carrying forward under and over spends.

1.32. We have not examined the format of these documents in detail and we remain mindful of the need for authorities to establish their own arrangements to manage these matters. That said, the sorts of areas that are covered to a greater or lesser extent by such protocols include the approach to establishment, management and reporting on reserves as shown in Exhibit 10.

Exhibit 10 – Contents of protocols for the management of reserves

Protocol for general reserves	Protocol for earmarked reserves
• Who is involved in decision making and review? • Who is responsible for ensuring decisions are implemented? • What risks need to be covered? • When will the general reserve be reviewed? • When to increase or decrease the general reserve? • How much will be held in general reserves?	• Who is involved in decision making and review? • Who is responsible for ensuring decisions are implemented? • For what purposes earmarked reserves will be held. • What risks need to be covered when establishing, reviewing and utilising earmarked reserves? • When an earmarked reserve will be established.

Protocol for general reserves	Protocol for earmarked reserves
• How will information about general reserves be reported?	• When earmarked reserves will be reviewed. • When to use or close an earmarked reserve. • When to replenish an earmarked reserve. • How much will be held in general reserves? • How will information about reserves be reported?

Improvements have been made to risk assessment processes and better links are being made to the developing Medium Term Financial Plans

1.33. Most councils use some form of risk assessment to determine their minimum level of general reserves, but these were of variable quality. Councils are routinely looking to the medium term and using reserves to smooth the effects of funding reductions and spending pressures in the context of their savings plans and managing external cost pressures. There are specific examples of local authorities undertaking a risk assessment process as part of their review processes and reporting this to Members. This is something that has taken on a greater significance in recent years, particularly as a result of increased pressures on local authority finances.

1.34. There are also examples of authorities clearly linking their reserve position with their medium-term financial strategies. It is fair to say that medium term financial planning is a developing process across Wales and authorities are at various stages of their development. However, it makes good sense for these strategies to include clear reference to the planned use of reserves, particularly factoring in how earmarked reserves are to be established and utilised as part of the plans. Such an approach would be helpful in supporting the CFO in explaining in a transparent manner the need for and planned use of reserves.

1.35. The build up of earmarked reserves over recent years does not appear to be the result of poor financial management, ie as a result of budgets remaining under spent at the year end and the subsequent transfer to earmarked reserves. Reserves appear to have been built up intentionally through the budget to cover future costs. Where under-spends or fortuitous circumstances have allowed funds to become available, more often than not, these are set aside in earmarked reserves rather than adding to the general reserve balance because of the need to meet specific future cost pressures, whether they be national or local in nature. Similarly, once earmarked reserves have been established, CFOs have been very cautious in releasing these reserves as there are always other pressures and uncertainties that can be identified for the future.

Whilst there has been improvement in recent years, there is scope for improved reporting on the management of reserves during the financial cycle and in financial statements

Financial statements are often lengthy and highly detailed which can make finding and interpreting information on reserves a challenge

1.36. Whilst the actual position on general and earmarked reserves is shown in the annual financial statements, these are lengthy complex documents and without a degree of specific knowledge it can be difficult to ascertain a full picture of the reserves held and their usage.

1.37. The Audit Commission publication: "Let's be clear – making local authority IFRS accounts more accessible and understandable" (published January 2012) concluded:

"Local Authority accounts are difficult to understand. Even professional local government accountants can find the statutory accounts hard to explain."

1.38. The report comments on the need for professional bodies, auditors and local authorities to work together to reduce clutter in the statutory accounts. Better summarised information could also be made more easily available to support the needs of a wider range of users including elected representatives and the public. CIPFA has published a briefing: "How to Tell the Story" which helps CFOs and other finance professionals to explain to their authorities the most important parts of the financial statements. CIPFA's briefing explains how the statutory accounts can be used effectively to convey information in:

- comparisons with budgets;
- general fund and HRA performance;
- the reserves positions; and
- cash flows.

1.39. By way of an example, in Scotland, local authority Directors of Finance have agreed in principle to include in their explanatory foreword to the accounts, a number of selected financial ratios. The intention is to support interpretation of the financial statements and an explanation of the authority's financial position and performance. Inclusion of the ratios is not mandatory (*Source: LAAP Bulletin 93 entitled "Closure of the 2011-12 Accounts and Related Matters" issued in March 2012*). The financial ratios selected are shown in Exhibit 11 below:

Exhibit 11 – Financial ratios (Scotland)

Indicator Category	Indicator Details
Reserves 1	Uncommitted General Fund/Annual Budgeted Net Expend (normally as a %).
Reserves 2	Movement in the Uncommitted General Fund Balance (value or % change).
Council Tax 1	In-year collection rate (%).
Council Tax 2	Council Tax Income/Overall Funding (%).
Financial Management 1	Actual out-turn compared to budget [net service expend] (value &/or %?).
Financial Management 2	Actual contribution to/from Uncommitted General Fund balance (value).
Debt & Borrowing [Prudence] 1	Capital Financing Requirement [current year].
Debt & Borrowing [Prudence] 2	External Debt levels [current year].
Debt & Borrowing [Affordability] 1	Ratio of financing costs to net revenue stream.
Debt & Borrowing [Affordability] 2	Impact of Capital investment on Council Tax & Housing Rents.

The level of information recorded in financial statements to explain specific earmarked reserves varies

1.40. All Local Authorities in Wales include in their accounts a statement on the movement in reserves as required by the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). This is a useful statement which shows the balances and movements on the main categories of usable and unusable reserves. This is then supplemented by more information in the notes to the accounts on specific earmarked reserves.

1.41. A review of earmarked reserves disclosed in the financial statements identifies varying levels of disclosure and clarity about the purpose, use and expected timing of calls on the reserves. Our analysis of earmarked reserves in Exhibit 4 identifies that the majority of earmarked reserves can be easily identified directly from the financial statements. Whilst this analysis shows the typical earmarked reserves held by authorities across Wales, there were many earmarked reserves where the purpose was more difficult to understand.

1.42. It is possible that this is partly the result of local authorities wishing to maintain an element of confidentiality in relation to the narrative around some reserves, eg equal pay reserves or reserves set aside to manage any unresolved litigation. However, some earmarked reserves are just ambiguous in terms of the narrative and could in fact be treated as general reserves, eg income equalisation reserves and further disclosure of the nature, purpose and expected timing of calls on the reserve would benefit the readers of accounts.

Some Authorities report on reserves across the whole financial reporting cycle

1.43. Information on reserves is generally presented to members at two key stages within the financial cycle:

- at the budget setting stage (at the beginning of the financial year); and
- at the financial accounts reporting stage (at the end of the financial year).

1.44. A number of authorities provide information on reserves to members through each of the various other stages of the financial cycle as identified in Exhibit 12 below.

Exhibit 12 – the financial reporting cycle

1.45. Local authorities should consider their current position in terms of reporting reserves to members in the context of the financial reporting cycle as a whole. Reference to the audit committee is particularly relevant in light of the requirements set out in the recent Local Government Measure, which are currently being implemented by Authorities following the publication of final guidance in June 2012.

1.46. CFOs also reported that they are communicating with members in other (less formal) ways during the financial reporting cycle, for example, presentations and meetings to discuss draft budget proposals. The CFOs play a crucial role in understanding the needs of, and controlling the flow and quality of, information to members and, overall, good practice would indicate that more information could be provided at various stages to support the understanding of the purpose and use of reserves throughout the financial cycle.

1.47. A key piece of the information members receive to inform their decisions in relation to reserves is the CFO's report on the robustness of estimates and the adequacy of reserves (the s25 report) which must be provided as part of setting the annual budget. The detail contained within such reports varies, however one Authority interviewed identified that they provide a lot of information to support the statement in terms of general reserves as shown in Exhibit 13.

Exhibit 13 – Example detail provided in S25 statement on the level of reserves

Issues considered when reporting general fund levels at the budget setting stage
• An explanation of general fund reserves.
• Approach to setting general fund reserves.
• Reference to risks.
• Links with other reserves.
• Links to known budgetary pressures and recent overspends.
• Examination of their level and purpose with clear reference as to why some reserves are too high, no longer necessary or why new reserves have been created.
• Actual values used for minimum levels.
• Benchmarks re minimum levels of general reserves.
• A clear reference to general reserves in the context of other reserves. In our review, this is particularly relevant given that earmarked reserves form part of the general fund and there remains discretion as to what a council can do with earmarked reserves.
• A clear reference to the pattern of both earmarked and general fund reserves to the period to 2015 with relevant references to the Medium Term Financial Plan.

1.48. In addition to the financial statements, it is sometimes difficult to understand the information supporting reserves at all stages of the financial cycle. To support the disclosure and interpretation of reserves within the local authorities' financial reporting cycle, local authorities could use the following categories to contextualise the basis for holding reserves:

- degree of certainty in relation to the liability occurring;
- whether the payment stream is likely to be short or long term in nature;
- the strategic significance of the reserve; and

- whether the reserve has been set up as a result of events outside the control of the local authority, eg changes in legislation.

1.49. Some authorities were very clear about the reserves held and their specific purposes. For example, one authority made it very clear that their earmarked reserves fell into three broad categories:

- Capital (with specific reference to amounts, timings of cash flows and purpose);
- Insurance reserves; and
- other earmarked reserves (with clear reference to sub categories, classes of reserves, their purpose, timing and links to spending plans).

1.50. In their report to members, it was relatively straightforward to understand the context of earmarked reserves and the purposes for which they were held and expected timing. This clarity came through in respect of their financial reporting included in the end of year financial statements.

1.51. We also found evidence of a number of Authorities who supplement their year-end financial accounts with a complimentary 'closure of accounts report'. Whilst this contained explanations covering many aspects of the financial statements, it also contained detailed reporting around the levels of reserves and specific movements and explanations and links to the medium term financial plan.

2. The use of unsupported borrowing has generally increased and been used for a variety of schemes although affordability remains the key challenge

The flexibility provided by the use of unsupported borrowing has been widely supported by Chief Finance Officers in Wales but affordability remains the key challenge

Legislation sets out the framework within which local authorities can make use of unsupported borrowing

2.1. Prior to 2004-2005, local government bodies could only borrow when they had a 'credit approval'. However, the Local Government Act 2003(LGA 2003) provided local government bodies with the power to borrow for any purpose relevant to its functions or for the prudent management of its financial affairs.

2.2. As a consequence of the LGA 2003, the extent of borrowing is controlled by the local government bodies themselves, through the determination of the 'affordable borrowing limit', although the Welsh Government does have reserve powers to impose limits on borrowing. The LGA 2003 therefore provided local government bodies with much more discretion regarding the amount of resources it committed to capital investment and the amount that it committed to current (revenue) expenditure.

Unsupported borrowing is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities

2.3. The duty to determine the level of affordable borrowing places reliance on self-regulation under professional codes of practice, including the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities (Prudential Code). Local authorities have a duty to determine the affordable borrowing limit (ABL) which covers both supported and unsupported borrowing. Local authorities undertake borrowing and credit arrangements that attract central government support, referred to as supported borrowing. Unsupported borrowing is borrowing funded from the Authority's own revenue resources.

2.4. The Prudential Code plays a key role in capital finance in local authorities. Local authorities determine their own programmes for capital investment in non-current assets that are central to the delivery of quality public services. The Prudential Code was developed by CIPFA, the Chartered Institute of Public Finance and Accountancy, as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by Regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003 referred to above.

2.5. The framework established by the Prudential Code is intended to support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. In exceptional cases the Prudential Code should provide a framework which will demonstrate that there is a danger of not ensuring this, so that the local authority concerned can take timely remedial action. To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The Prudential Code does not include suggested indicative limits or ratios. These will be for the local authority to set itself, subject only to any controls under section 4 of the Local Government Act 2003 (England and Wales). The prudential indicators required by the Prudential Code are designed to support and record local decision making in a manner that is publicly accountable. They are not designed to be comparative performance indicators. They should be considered in parallel with the treasury management indicators required by the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

2.6. The legal status of the Treasury Management (TM) Code derives in England and Wales from regulations issued under the Local Government Act 2003 (the 2003 Act). The Capital Finance and Accounting Regulations 1 explicitly require English and Welsh authorities to 'have regard' to the TM Code. The TM Code and the Prudential Code are closely linked. All authorities in the UK are required to have regard to the Prudential Code when setting limits to the level of their affordable borrowing under section 3(5) of the 2003 Act (in England and Wales).

The flexibility provided by the use of unsupported borrowing has been widely supported by Chief Finance Officers in Wales

2.7. When introduced in 2004, prudential borrowing marked a major shift in how local authority capital spending was managed. Our review has confirmed that the flexibilities provided through the use of unsupported borrowing have been well received by Chief Finance Officers in Wales. The key reason has primarily centred on its flexibility, with local authorities commenting positively in respect of unsupported borrowing:

- enabling local authorities to manage their capital programmes more effectively over the medium term;
- offering a real alternative where other alternative sources of funding are no longer available, eg capital receipts, grants, PFI credits;
- enabling local authorities to support their capital programmes in light of significant reductions in central supported funding alternatives from the Welsh Government (either through supported borrowing or grants); and
- providing more autonomy in terms of local decision making.

Affordability remains the clear challenge facing local authorities in their use of unsupported borrowing

2.8. Affordability is the clear, overarching challenge in relation to unsupported borrowing. The majority of authorities commented on the difficulties of having to self finance unsupported borrowing against the backdrop of reductions and increased pressure on future revenue resources. Overall, authorities in Wales faced a £155 million (3.8 per cent) real-terms reduction in their revenue funding from the Welsh Government in 2011-12. Indicative figures show that in real terms, the revenue funding from the Welsh Government will be around £283 million (seven per cent) lower in 2013 than 2010-11 (*Source: WAO Picture of Public Services report*).

2.9. Whilst funding for unsupported borrowing is from revenue, it is used to pay for capital items. As referred to above, Authorities are forecasting a 28 per cent reduction on capital programmes in 2012-13 (*Source: WAO Picture of Public Services report*) and further reductions after that, which increases pressure on Authorities to use borrowing as a source of finance. Therefore they are balancing having to fund more capital by unsupported borrowing which commits future revenue at a time when future revenue is reducing also.

2.10. Some authorities commented that there is a reluctance to take on debt which had to be financed from revenue streams – this was commonly referred to as 'mortgaging the future', as this funding essentially then needs to be ring-fenced from revenue over significant periods of time (typically 20 to 30 years for building projects). Other comments centred around external factors relating to the instability of financial markets (specifically interest rates).

2.11. Reference has also been made to the political dimensions of taking on borrowing. For example, politicians may be reluctant to increase borrowing and commit the authority to long-term debt charges – partly for the reasons outlined above or partly due to other views about borrowing in general.

2.12. The Welsh Government has recently announced an initiative to fund Highway capital works from unsupported borrowing. When translated into capital spend, this will have an impact of providing local authorities in Wales with an additional £60 million in 2012-13 and around £170 million over the next three years for highways maintenance. The announcement of this scheme was generally welcomed amongst Chief Finance Officers in Wales. However, there were a number of initial comments and concerns regarding the initiative. In summary, these related to:

- the removal of local decision making in determining spending priorities;
- removing the flexibility at central government level by tying up revenue resources over a 22 year period; and
- concerns over the lack of transparency of the funding streams on the basis that the funding is rolled up within the revenue support grant.

2.13. The 21st Century Schools Programme is being developed as a partnership between Welsh Government, the Welsh Local Government Association, Diocesan Directors of the Voluntary Aided Sector and Colleges Wales. The programme amounts to capital investment in school buildings across Wales of £1.4 billion. Through the partnership, a programme has been agreed that will ensure that all 22 local authorities will receive Welsh Government capital support of £700 million in total over a seven year period.

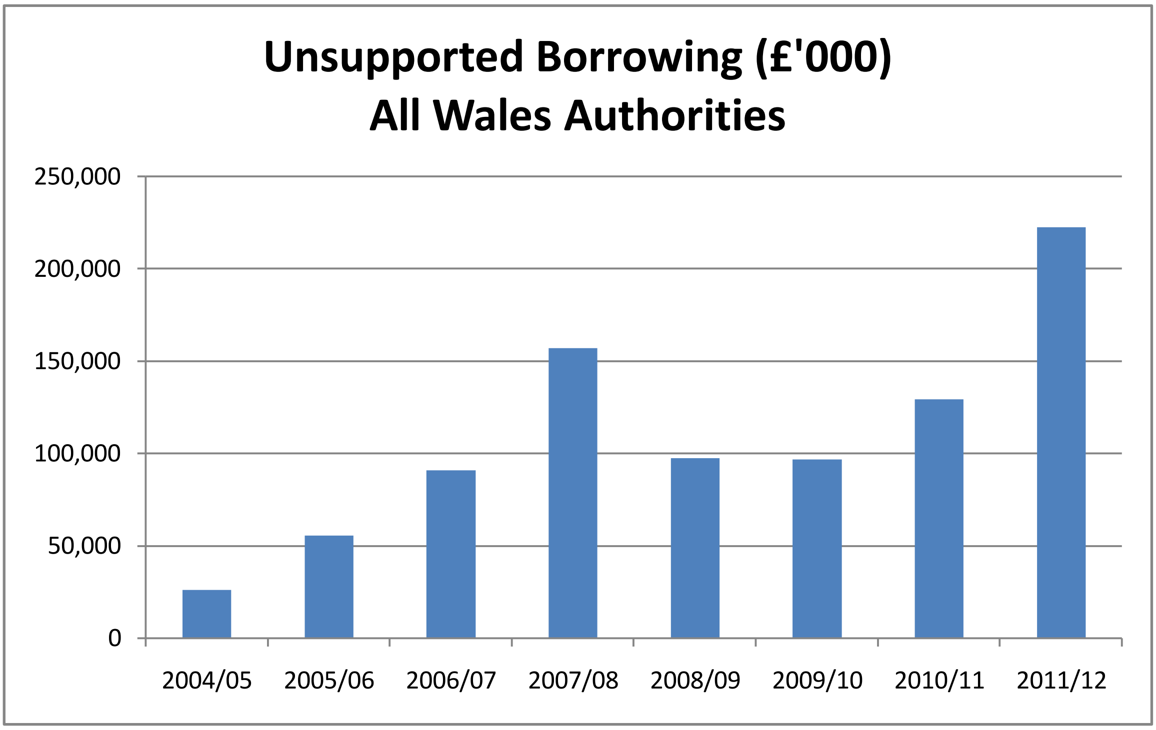
2.14. This investment will build upon the £415 million of capital investment that is already being provided by the Welsh Government from the Transitional Funding programme. This programme, a precursor to 21st Century Schools, is nearing completion and will dovetail into this new programme which is currently planned to start in 2014-15. Local authorities are in the process of establishing their funding requirements to meet the 50 per cent matched funding criteria. Whilst we have not reviewed these early plans, we envisage that inevitably there will be funding gaps that will need to be filled by varying levels of unsupported borrowing across local authorities in Wales.

Unsupported borrowing has increased significantly in 2011-12 and the trend is set to continue in 2012-13

The level of unsupported borrowing has increased significantly in 2011-12

2.15. In 2004-05, £26 million of the total capital expenditure of £819.4 million was financed from unsupported borrowing (*source: Welsh Government Statistical returns)*. This equates to just 3.2 per cent of the total capital expenditure figure. In 2010-11, unsupported borrowing of £129.2 million was undertaken, financing 13.7 per cent of the £943.8 million capital expenditure. Capital finance forecasts for 2011-12 identify that unsupported borrowing will rise to over £200 million, financing in the region of 24 per cent of the capital expenditure forecast. Unsupported borrowing levels amongst Welsh local authorities can be seen in Exhibit 14 below. These figures represent the amount of unsupported borrowing undertaken in each financial year.

Exhibit 14 – unsupported borrowing levels in Welsh local authorities 2004-05 to 2011-12



2.16. Exhibit 15 below shows how local authorities intend to finance their expenditure in 2011-12, external support and internal financing are shown separately. Unsupported borrowing makes up almost a quarter of all capital financing:

Exhibit 15 – Financing of forecast capital expenditure in Wales 2011-12

General capital funding / Government grant	22.9%	**External Support**
Supported borrowing	14.2%	
Grants from European Community Structural Funds	7.4%	
Capital Grants and contributions from other sources	5.7%	
Major Repairs Allowance	5.4%	
Unsupported borrowing	24.1%	**Internal financing**
Capital expenditure charged to revenue account	12.1%	
Use of capital receipts	8.2%	
	100%	

Source: Welsh Government statistics

The upward trend in unsupported borrowing is set to continue in 2012-13

2.17. Ninety per cent of local authorities expect unsupported borrowing to increase in 2012-13. We have not reviewed the extent to which local authorities will extend their unsupported but believe there are a number of factors which will lead to increased levels of unsupported borrowing going forward:

- the onset of the Welsh Government's highways funding scheme in 2012-13;
- the impact of 21st Century Schools in 2014-15 (even though this will form part of matched funding process, the significant level of capital expenditure will inevitably require local authorities to finance elements of the programme through unsupported borrowing);
- further reductions in capital funding;
- increasing levels of backlog maintenance; and
- pressure on local authorities to improve the quality of their asset base and achieve better levels of service for the user.

2.18. Exhibit 16 below shows the trends in unsupported borrowing in England compared to Wales over the last four years. Whilst unsupported borrowing levels have increased significantly in Wales, English local authorities have consistently been undertaking greater levels of unsupported borrowing, although the rate of change in Wales is greater.

Exhibit 16 – Unsupported borrowing as a percentage of capital expenditure (England and Wales)

	Unsupported borrowing as a percentage of capital expenditure WALES	Unsupported borrowing as a percentage of capital expenditure ENGLAND
2008-09	9%	21%
2009-10	11%	22%
2010-11	14%	27%
2011-12 (forecast)	23%	29%

Source: Welsh Government and Communities & Local Government statistics

Whilst the level of unsupported borrowing varies significantly between local authorities in Wales, there are many factors that contribute to the differences

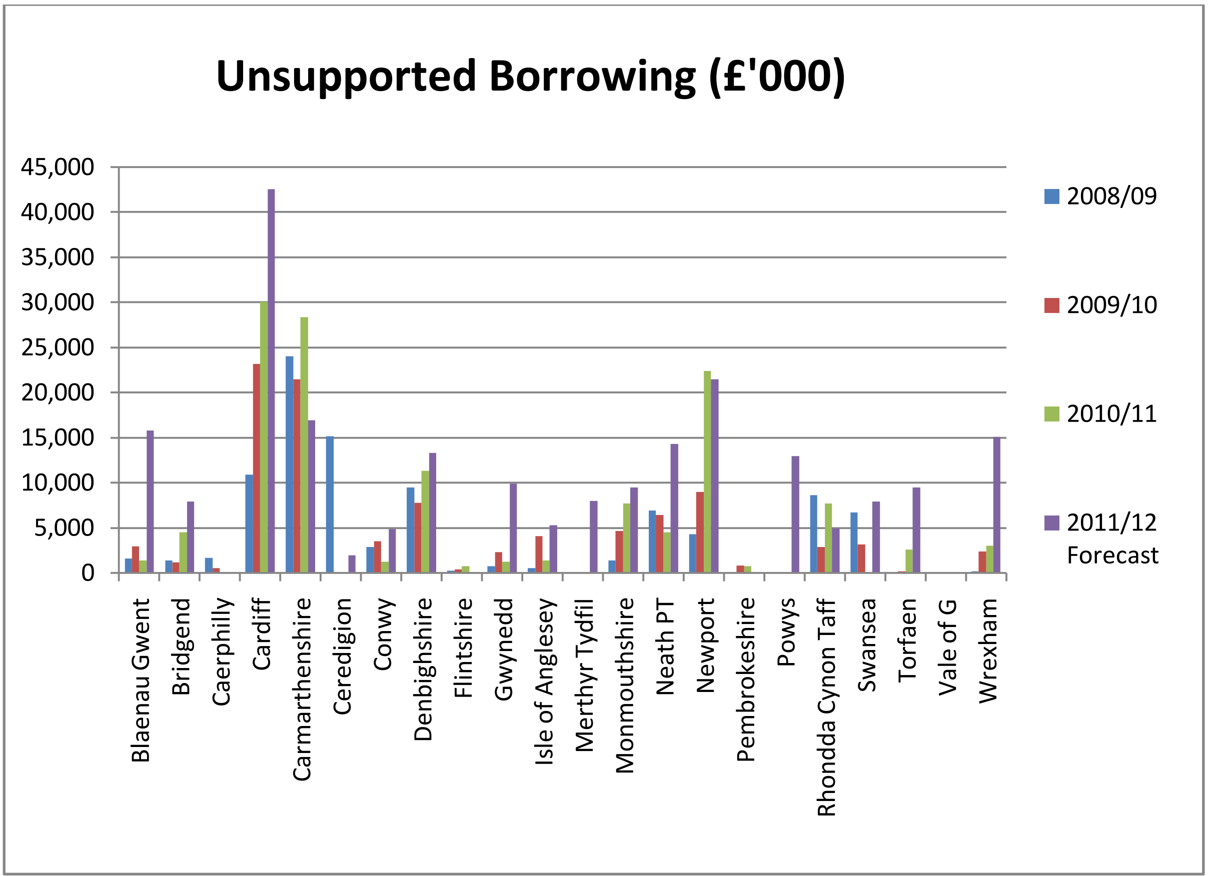
2.19. Our analysis shows that the level of unsupported borrowing varies considerably between local authorities in Wales. Exhibit 17 details the ranges of unsupported borrowing undertaken across local authorities in Wales for 2009-10, 2010-11 and 2011-12.

Exhibit 17 – range of unsupported borrowing across local authorities in Wales 2009-10, 2010-11 and the forecast for 2011-12

Range	2009/10	2010/11	2011/12 (forecast)
Unsupported borrowing	£0m to £23m	£0m to £30m	£0m to £43m
Unsupported borrowing as a % of capex	0% to 29%	0% to 40%	0% to 61%

2.20. Exhibit 18 identifies the levels of unsupported borrowing in value terms across each local authority in Wales for 2008-09, 2009-10, 2010-11 and 2011-12.

Exhibit 18 – Levels of unsupported borrowing undertaken by local authorities in Wales



2.21. Three authorities, over the past four years, have undertaken a significantly higher level of unsupported borrowing than other local authorities in Wales with a combined level of unsupported borrowing amounting to £255 million.

2.22. The levels of unsupported borrowing at each of these authorities were primarily attributable to:

- significant capital expenditure to support the housing business plan designed to achieve the Welsh Housing Quality standard;
- significant investment in the roads infrastructure to improve the highways system and reduce future maintenance and insurance costs; and
- significant investment in a schools rationalisation programme.

2.23. A key question could be raised as to why other authorities have not undertaken similar levels of unsupported borrowing as these three authorities. Taking the example of using unsupported borrowing to support investment in council housing, the position is going to vary across Wales as:

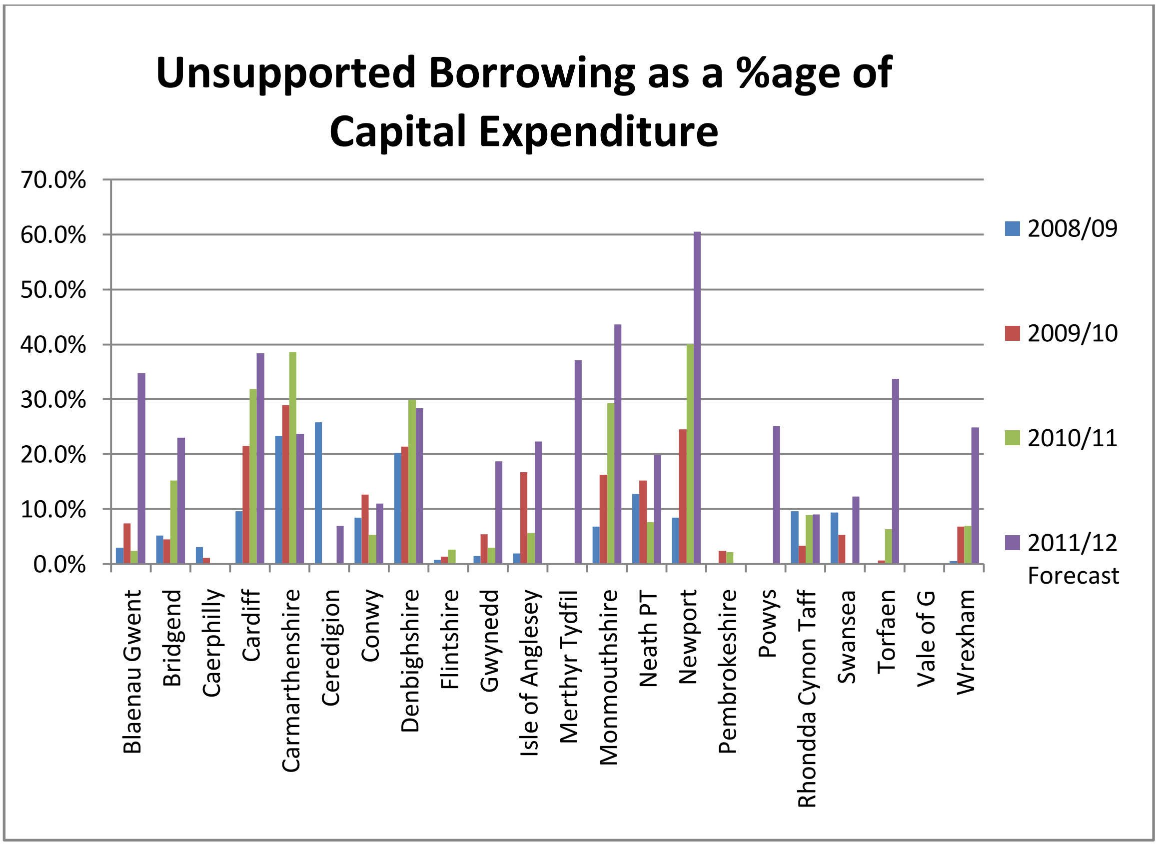
- Eleven local authorities have already transferred their housing stock to registered social landlords. These authorities do not have any further responsibility to meet the requirements of the WHQS and therefore will not require any unsupported borrowing to finance elements of their housing business plan.

- Of the 11 local authorities who have retained their housing stock:
  - some may still transfer their stock;
  - stock retention authorities are at different stages in terms of attaining the standard; and
  - the funding levels to meet the requirements of the business plan vary depending on the quality of the housing stock retained.

2.24. The key message here is that levels of unsupported borrowing need to be considered within the context in which that borrowing was undertaken.

2.25. Further analysis has been undertaken in respect of unsupported borrowing as a percentage of capital expenditure. Exhibit 19 below identifies the levels of unsupported borrowing (as a percentage of capital expenditure) across each local authority in Wales for 2008-09, 2009-10, 2010-11 and forecast for 2011-12. As can be seen, there is less of a differential between the levels of unsupported borrowing across Wales when compared to total capital expenditure. The level of unsupported borrowing must be viewed in the context of the capital expenditure programme for each local authority which vary considerably from authority to authority.

Exhibit 19 – Forecast unsupported borrowing as a percentage of capital expenditure by local authorities in Wales



2.26. Authorities indicated they would only use unsupported borrowing where it was appropriate and advantageous to do so. Put simply, some authorities felt that they did not have any need to undertake unsupported borrowing. Factors contributing to this position to date were:

- the levels of capital receipts being held;
- their position in respect of policy initiatives such as the Welsh Housing Quality Standard;
- the condition of the schools estate and backlog maintenance on other aspects of their asset base;
- the relative size of their capital programme; and
- the existence of earmarked reserves to cover matters such as vehicle repairs;

2.27. However, we did identify that authorities with little or no unsupported borrowing demonstrated that they had considered the option of unsupported borrowing for a number of schemes.

Unsupported borrowing has been used for a wide variety of schemes, primarily financed from future revenue savings

Unsupported borrowing for a variety of purposes and has been primarily financed from savings and revenue sources

2.28. Our research identified a selection of key schemes undertaken by local authorities over the last three years financed through unsupported borrowing. In 2011-12, these schemes were primarily financed through revenue streams with a smaller percentage of schemes financed through savings and efficiencies measures and income generation as shown in Exhibit 20 below.

Exhibit 20 – Unsupported borrowing – financing the borrowing costs (2009-10, 2010-11 and 2011-12)

Financing source	2009-10	2010-11	2011-12
Savings and efficiencies (including spend to save schemes)	64%	35%	22%
Direct from revenue budgets	29%	56%	61%
Income streams	7%	9%	17%

2.29. The schemes included in our analysis primarily focused on school improvement expenditure in respect of the Welsh Housing Quality Standard and highways improvement. However, a wide range of schemes, some of which were of low value, were identified which included:

- extensions and refurbishments of office buildings;
- street lighting schemes;
- fleet replacement programmes;
- residential care homes;
- window replacement schemes;
- CCTV schemes; and
- sports centre refurbishment; and town centre regeneration schemes.

2.30. A number of schemes have been used which show the variety of options and flexibility that unsupported borrowing has provided as shown in Exhibits 21, 22 and 23 below:

Exhibit 21 - Cardiff County Council – Schools Organisation Plan (SOP)

Cardiff County Council - School Organisation Plan (SOP)
The project is a plan to improve the provision of schooling in Cardiff with the aim of ensuring sufficiency of school places in areas of growth in both English and Welsh medium, in line with demand. It aims to invest in the condition of school buildings to meet 21st Century standards, increase efficiency and reduce costs by a continued reduction in the number of surplus places. The initial plan was for a city-wide approach, however, this was rejected as it failed to gain sufficient political support and a spotlight incremental approach was adopted. A specific Schools sub-Committee was created at which politicians and key stakeholders were consulted on the proposals including financial implications. Expenditure on the proposals since inception of the plan and in future years is forecast to be £203.6 million and this is funded predominantly via capital receipts, general fund capital resources, revenue financing and £96.9 million additional unsupported borrowing (with the associated finance charges funded from revenue release savings, eg from facilities management, falling pupil number savings and other efficiency savings). The funding also includes significant school building improvement grant from the Welsh Government. Without the use of unsupported borrowing, the funding would have been almost halved and would need to compete against other Council projects amid the backdrop of reducing Welsh Government capital resources. The plan is facilitated via a regularly reviewed and updated consolidated financial model with all proposals considered in the light of financial issues and risks. The key benefits of the use of unsupported borrowing include: • Unsupported borrowing allows the flexibility to produce a consolidated financial model for the SOP which covers capital and revenue costs over a longer time period, making a more holistic model. • Revenue release savings and the costs of unsupported borrowing are allocated to an earmarked SOP reserve. This allows the opportunity to unlock a larger investment programme and given the nature of schemes, eg consultation and statutory approval, allows flexibility in managing the timing of resources as a result of such risks. • It has provided a platform against which to complete bids for 21st Century Schools funding from Welsh Government, demonstrating the commitment of resources that the Council has made and is proposing to make in its schools.

Cardiff County Council - School Organisation Plan (SOP)

The establishment of a consolidated financial model has provided a mechanism for members to give due consideration to the financial implications of decisions, whilst the use of unsupported borrowing has allowed the Council to be ambitious in its plans for improving the provision of schooling in Cardiff.

Exhibit 22 - Conwy County Council – Plant and Vehicle Funding

Conwy County Borough Council - Plant and Vehicle Funding

Historically, the Council leased all its plant and vehicles. However, an analysis of the costs of leasing compared to the costs of PWLB for purchase of plant and vehicles (including the cost of staff time), highlighted that it was more cost effective and provided more flexibility to borrow and purchase equipment than to lease it. Put simply, the total cost of borrowing and the end of life asset sale worked out to be more cost effective than leasing.

The change from leasing to borrowing was considered to be a technical financing issue so a full business case was not prepared. However, the vehicle acquisition programme was added to the Capital Programme and approved via the annual budget process.

There are a number of benefits that arose from the project and the use of unsupported borrowing (between £1.5 million and £2 million per annum for the past five years) which included:

- less time spent by staff managing the capital financing aspects of vehicle acquisition;
- less interest to pay; and
- more flexibility with end of life issues (retention of good quality vehicles, early disposal of poor quality vehicles, disposal if services change, receipt of good auction prices for well maintained used vehicles).

Councillors have been fully supportive of the revised policy as the change was made to reduce costs. An annual analysis is carried out to check that borrowing remains cheaper than leasing.

Exhibit 23 - Pembrokeshire County Council – Ysgol Dewi Sant Sports Hall.

Pembrokeshire County Council - Ysgol Dewi Sant Sports Hall

Due to the dilapidations and declining community use of the swimming pool, coupled with a requirement for a local sports hall (for schools and the community), a plan was put together to locate a new sports hall on the site of the existing swimming pool.

The scheme fell outside of the strategic leisure investment programme and the project could not be financed unless the unsupported borrowing route was taken (unsupported borrowing - £1.3 million).

A business case was prepared and presented to the Cabinet which highlighted the key considerations and benefits of the project. These included factors such as:

- The existing pool was coming to the end of its useful life, was in poor condition, had reducing admission rates and increased running costs. Had it not been replaced with the sports hall, the facility would have become unserviceable leading to

Pembrokeshire County Council - Ysgol Dewi Sant Sports Hall
closure. • With the use of unsupported borrowing, it was proposed that a new sports hall/fitness suite replace the pool. • New swimming pool facilities were already available in the local area reducing the need for a local pool in St Davids. • The financing of a new sports hall could be supported by diverting the revenue resources already used to support the old swimming pool.

Procedures are in place to manage and report information in relation to unsupported borrowing and links are developing with longer term capital planning

2.31. Local authorities report the position on unsupported borrowing through the budget setting process (specifically the capital budget), the Treasury Management statement and the financial statements. CFOs indicated that they hold informative debates with Members in relation to unsupported borrowing, emphasising the differences with more traditional 'supported' borrowing. Generally, directorates/divisions are well versed in the potential of unsupported borrowing and are encouraged to explore the potential of unsupported borrowing, particularly when looking at spend to save initiatives and capital programme bids.

2.32. A number of authorities were able to provide evidence as to how unsupported borrowing (and capital planning as a whole) linked to the medium term financial strategy. However, these medium-term financial strategies did not undertake a longer term strategic view in respect of capital planning. Whilst we appreciate that this has been partly down to factors such as reliance on grant funding, there is an opportunity to invest in longer term capital planning for services linked to asset management plans (eg HRA, Highways), as part of developing the arrangements for medium term financial planning.

2.33. Unsupported borrowing will be a key component of longer term capital planning. Given the reductions in capital funding going forward, long-term planning and the use of unsupported borrowing will be critical to authorities. Some expressed the view that without the use of unsupported borrowing it is difficult to envisage how local authorities will manage to keep a number of services safe and legal, yet alone go anywhere near to achieving their aspirational aims and objectives.

Appendix 1

Appendix 1 – key legislation which sets the framework within which local authorities maintain financial reserves

Act	Requirement
Local Government Finance Act 1992 s32 – Calculation of budget requirement (by authorities in Wales) *This section acknowledges the need for reserves and sets out the duty on billing authorities to calculate its expected expenditure and income, including contributions to and from reserves.*	S32 (1) A billing authority (in Wales) shall make the calculations required by this section. S32(2) The authority must calculate the aggregate of: a) the expenditure which the authority estimates it will incur in the year in performing its functions and will charge to a revenue account for the year; b) such an allowance as the authority estimates will be appropriate to raise in the year for meeting its estimated future expenditure; c) the financial reserves which the authority estimates will be appropriate to raise in the year for meeting its estimated future expenditure; and d) such financial reserves as are sufficient to meet so much of the amount estimated by the authority to be a revenue account deficit for any earlier financial year as has not already been provided for. S32(3) The authority must calculate the aggregate of: a) the sums which it estimates will be payable for the year into its council fund and in respect of which amounts will be credited to a revenue account for the year, other than sums which it estimates will be so payable in respect of re-distributed non-domestic rates, revenue support grant, additional grant; and b) the amount of the financial reserves which the authority estimates that it will use in order to provide for the items in paragraphs (a) and (b) of subsection 2. S32(4) If the aggregate calculated under subsection (2) exceeds that calculated under subsection (3) above, the authority must calculate the amount equal to the difference; and the amount so calculated shall be its budget requirement for the year.
Local Government Act 2003 S25 Budget Calculations: report on robustness of estimates etc *This places a duty on the CFO to report on the adequacy of proposed reserves and for the authority to have regard to the report.*	1) Where an authority to which section 31A, 32, 42A or 43 of the Local Government Finance Act 1992 applies is making calculations in accordance with that section, the chief finance officer of the authority must report to it on the following matters: (a) the robustness of the estimates made for the purposes of the calculations; and (b) the adequacy of the proposed financial reserves. 2) An authority to which a report under this section is made shall have regard to the report when making decisions about the calculation in connection with which it is made.

Act	Requirement
Local Government Act 2003 s26 Minimum Reserves *This gives the Secretary of State/Welsh Ministers the power to set minimum reserves*	1) This section has effect in relation to the estimate of financial reserves for the purpose of calculations in accordance with: (a) section 32 of the Local Government Finance Act 1992 (calculation by billing authority of budget requirement for financial year); and (b) section 43 of that Act (corresponding provision for major precepting authority). 2) In the case of a controlled reserve, it shall not be regarded as appropriate for the balance of the reserve at the end of the financial year under consideration to be less than the minimum amount determined in accordance with regulations made by the appropriate person. 3) In subsection (2), “controlled reserve” means a financial reserve of a description specified for the purposes of this section by regulations made by the appropriate person.

Appendix 2

Appendix 2(i) – an explanation of the usable reserves held by local authorities in Wales

Usable Reserves – cash backed reserves that can be used to fund future expenditure (subject to any restrictions on usage)	
Name	**Description**
General/Council Fund	This is a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing and forms a contingency to cushion the impact of unexpected events or emergencies. No specific statutory restrictions.
Earmarked Reserves	These reserves are a means of building up funds, to meet known or predicted requirements; earmarked reserves are accounted for separately but remain legally part of the general fund. These could be sums set aside for major schemes, such as capital developments or asset purchases or to fund major reorganisations, insurance reserves (self insurance), reserves of trading and business units or reserves retained for service departmental use. The Code requires that for each earmarked reserve held by a local authority, there should be a clear protocol setting out: • the reason for/purpose of the reserve; and • how and when the reserve can be used.
HRA Reserve	The Local Government and Housing Act 1989 requires housing authorities to maintain a housing revenue account. The HRA is ring-fenced, meaning that funds are kept separate from other local authority income and expenditure streams, to make sure that council house rents are not used to subsidise general council expenditure and to prevent the general council tax payer subsidising council housing. Authorities may earmark part of the HRA reserve in additional to keeping a ‘general’ HRA reserve. Any HRA reserve balance must therefore be applied to the expenditure relating to the HRA only.
Schools Reserves	These are unspent balances of budgets delegated to individual schools under schemes of delegation.
Capital Receipts Reserve	This reserve holds the proceeds from the sale of assets, and can only be used for capital purposes in accordance with regulations. **Local Government Act 2003 (s9)** 1) References in this Chapter to a capital receipt, in relation to a local authority, are to a sum received by the authority in respect of a disposal by it of an interest in a capital asset. 2) An asset is a capital asset for the purposes of (1) if, at the time of disposal, expenditure on the acquisition of the asset would be capital expenditure.

Usable Reserves – cash backed reserves that can be used to fund future expenditure (subject to any restrictions on usage)	
	Local Government Act 2003 (s11) 1) The Secretary of State may by regulations make provision about the use of capital receipts by a local authority. 2) Regulations under (1) may, in particular: a) make provision requiring an amount equal to the whole or part of a capital receipt to be used only to meet: i) capital expenditure; or ii) debtors or other liabilities; b) make provision requiring an amount equal to the whole or part of any capital receipt to be paid to the Secretary of State. (2b only applies to receipts derived from the disposals of interest in housing land.) Regulation 9 of *Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (as amended)* does allow receipts that would ordinarily be capital receipts but are under £10,000 to be retained as revenue receipts.
Capital grants unapplied	This a reserve for holding grant funding that has been received and recognised in the Comprehensive Income and Expenditure Statement (CIES) as the conditions set by the grant funding body have been met but the expenditure to be funded by that grant has not yet been incurred. This treatment is required under 'proper practices' and it is likely that the funding will need to be matched against eligible expenditure (rather than being used for general funding) otherwise the authority could run the risk of funding being clawed back.

Appendix 2(ii) – an explanation of the unusable reserves held by local authorities in Wales

Unusable Reserves –	
Name	**Description**
Revaluation Reserve (previously Fixed Asset Restatement Account)	This reserve records unrealised gains in the value of fixed assets. The balance on the reserve increases when assets are revalued upwards and decreases as revalued assets are depreciated, revalued downwards or disposed of.
Capital Adjustment Account (previously Capital Financing Account/Reserve)	A specific accounting mechanism used to reconcile the difference between the rate at which non-current assets are depreciated and impaired under proper accounting practice, and the rate at which they are financed under the capital controls system. In Wales, *the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (as amended)* require the minimum revenue provision to be recognised in the Council Fund each year.
Financial Instruments Adjustment Account	A specific accounting mechanism used to reconcile the different rate at which gains and losses relating to financial instruments (such as premiums and discounts on the early repayment of debt) are recognised under proper accounting practice compared with the charge which statute requires to be met from the Council fund. In Wales, the statute is *the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (as amended).*
Available for sale financial instruments reserve	A reserve that records unrealised gains arising from holding available-for-sale investments, plus any unrealised losses that have not arisen from impairment of the assets. In Wales, the statute is *the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (as amended).*
Pensions reserve	A specific accounting mechanism used to reconcile the cumulative difference between the payments made to various statutory pension schemes in accordance with statutory requirements and the net change in the authority's liability under IAS19 *Employee Benefits*. An appropriation is made to or from the pensions reserve to ensure that the charge to the Council fund reflects the amount that needs to be raised in taxation.
Unequal back pay account	A specific accounting mechanism used to reconcile the different rates at which payments in relation to compensation for previous unequal pay are recognised under proper accounting practice and are required by statute to be met from the Council fund. In Wales, the statute is *the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (as amended).*

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