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Blog: Council reserves – Pickles does have a point

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Written by Chris Game

My keyboard is having some difficulty typing this, but, after much contemplation and inner torment, it reckons – and I do follow its reasoning – that, on the vexed topic of council reserves, Eric Pickles was not all wrong. Partly wrong, yes; needlessly provocative, of course – with his headline-seeking remarks last November, on the eve of an eye-wateringly tough finance settlement, about councils hoarding reserves and turning town hall vaults into Fort Knox; but yes, he did and does have a point.

That the present tense can be added is thanks to LGC's recent survey, using Freedom of Information requests, of councils' projections of their end-of-year reserves in March 2012 (LGC, 17 November - http://www.lgcplus.com/finance/councils-forced-to-live-on-financial-brink/5037848.article). The tone and title of LGC's report – 'Councils forced to live on financial brink' – and its analysis of councils' returns all seemed aimed at refuting Pickles' hoarding accusation by headlining the number of councils (49 out of 158, or 31%), whose projected end-of-year reserves would be below the 'minimum agreed' figure in their budget, irrespective of the percentage of the council's overall revenue spending either figure happened to represent. The purpose of this blog is to examine and question those largely disregarded percentages, and thereby give some additional value to LGC's research.

I should emphasise here – before it becomes embarrassingly obvious – that I am not a finance expert. I accept completely that LGC's findings and comparisons are important indicators of the plight of many councils, operating right at the edge of their financial limits and prohibited from running deficit budgets. My question is that surely the issues of just how close to the edge those limits were set, and how close a council's shortfall will actually take it, have some relevance as well?

In a few extreme cases, any and all figures are worrying. Shropshire UA included in its net revenue budget of around £750 million an exceptionally low 1.86% general reserve of £13.3 million – and estimate finishing £9 million short of that figure next March. The shortfall seems alarming, but so too, it seems to me, is the initial 1.86%. Compare Forest Heath DC. They're also projecting a shortfall, but one of only £79,000 of a budgeted general reserve of £2 million, and the estimated £1,920,577 reserve will still amount to 19.2% of the council's £10 million revenue budget. The concern here would seem to be less any imminent prospect of the council going broke, than why it should budget for a 20% reserve in the first place.

It was by no means the highest percentage among LGC's respondents, and, since all these high percentages were set by relatively low-spending district councils, comparisons with Fort Knox hardly apply. Still, since I happened to be on a long train journey and had a calculator about my person, it seemed worth investigating further. The following table was the first product of my labours.

	General reserves minimum limit set in 2011/12 budget (% of total net rev. expend.)		Projected general reserve level (31 March 2012)	
	Average	Highest	Average	Highest
12 County Councils	2.3	3.4 Kent	2.9	4.0 Suffolk
14 Metrop. Boroughs	3.1	6.3 Rochdale	3.5	6.3 Rochdale
21 Unitart authorities	4.1	6.9 Darlington	5.3	13.1 Darlington
13 London Boroughs	5.0	7.5 Bromley	6.3 (excl Bromley 4.8)	24.9 Bromley
76 District Councils	10.8	33 W. Oxfordshire 29 Epsom & Ewells	21.2	108.7 Surrey Heath 102.1 Tunbridge Wells 85 W. Oxfordshire

When Eric Pickles accused some councils of sitting on unjustifiably large reserves, those guessing he might have them in mind produced a predictable variety of defences. Most of their supposed reserves were actually earmarked for specific projects or purposes; additional money had to be set aside for redundancy payoffs; besides, fluctuating reserves were an integral and cunning part of the council's medium-term financial plan. Partly, no doubt, in anticipation of such responses, the LGC questions left as little room for confusion or subsequent wriggling as possible.

For budgeting purposes, reserves are divided into earmarked/allocated and general/unallocated, in what nationally is very roughly a 2:1 ratio. Earmarked are those held to meet specific known or anticipated liabilities – equipment replacement, property maintenance, PFI schemes, future insurance claims, election costs, etc.; general reserves are to deal with unpredictable events or uneven cash flows. LGC asked only about councils' general reserves: (a) the minimum limit budgeted for in 2011-12, expressed both in cash terms and as a percentage of the council's overall net revenue expenditure; and (b) projected general reserve levels for 31 March 2012. It seemed straightforward enough; even so, there were several cases where it looked as if reported figures might be incorrect or disputed – like the apparent addition of Transport for London's £245 million reserves to the Mayor's GLA budget – they were excluded, which is why my table covers only 136 authorities, rather than LGC's 158.

Perhaps surprisingly, for those used to central government's detailed control over English local authority finance, there is no statutory guidance on the minimum reserves councils should hold. CIPFA and Audit Commission advice is available, and the AC required 'Excellent' or 4-star authorities to have reserves equal to at least 5% of their net budget, which has become a kind of conventional or professional wisdom. But ultimately, and properly, a council's adviser on these matters is its Section 151 officer – which explains how, though unfortunately not why, some of the figures in the table vary to such an apparently extraordinary degree.

Only some of the figures, though. Grouping the LGC's alphabetical listing of authorities into council types produces two forceful findings, which, even if unsurprising to the professionals, rarely seem to receive much of a public airing. First, the figures for the counties, metropolitan boroughs, unitaries and, in the main, the London boroughs in LGC's sample were both noticeably clustered and, from a ministerial viewpoint, irritatingly responsible. With few exceptions – Conservative Bromley being the outstanding one – these councils budgeted for general reserves of between 2% and 5% of their net budget – and, moreover, expected at the end of the year to be within a gnat's crotchet of that budgeted figure, as the late Humphrey Lyttelton might have put it on 'I'm Sorry I Haven't a Clue'.

It is here, therefore, that it seems to me Pickles was wrong. If there were untapped billions sloshing around, these STCCs (single-tier and County Councils) would be the authorities holding them, but their own statistics show their unallocated reserves to be, if anything, on the low side of traditionally propounded best practice.

The second finding is that some hoarding clearly is taking place: there Pickles was surely right. But statistically those responsible are almost without exception shire district councils, and the sums involved, in the great scheme of things, fairly modest. It seems widely accepted – though usually without any conclusively convincing explanation – that districts always hold proportionately higher levels of reserves than STCCs. Even so, two questions arise.

First, why do some councils take the idea of general reserves being a barometer of a council's financial health to quite such extremes? All these broadly similar councils presumably carry out risk assessments, which lead most of their finance directors to advise and approve general reserves of around 10% of the net budget? So what's happening on those councils setting aside reserves of more than 20%, and do their taxpayers appreciate the hyper-healthy councils they're supporting?

Second, how, particularly in the present financial climate, do some councils manage to end the year with two, three or even four times the reserves for which they budgeted – and which in some cases exceed their total revenue expenditure? In the phrase so overused by stand-up comedians, what's that about? In fact, what's the whole reserve management process about? Should we be concerned, like Pickles, that our council's reserves may be indulgently rather than healthily high, or, like LGC, that they're dangerously rather than efficiently low? When LGC first published its findings, a 'most senior finance expert' warned that raising such questions was likely to 'open up a can of worms'. I do so hope they're right.

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