

Report to: Police Authority
Agenda item: 6
Date: 8 July 2010
Subject: Review of Reserves
Sponsor: Chief Executive
Author: Director of Finance and
Corporate Services and Treasurer
For: For Discussion and Decision

The Forum
5th Floor North
74-80 Camden Street
London NW1 0EG

T: 020 7383 0259
F: 020 7383 2655
E: general.enquiries
@btpa.police.uk

www.btpa.police.uk

1. Purpose of paper

- 1.1 The purpose of this paper to explain the nature and size of the financial reserves stated on the British Transport Police Fund balance sheet as at 31 March 2010 in order to make recommendations as to their use and how they might be better stated to support the Authority and Force. This issue has already been discussed at the Audit Committee on 29 June 2010 and incorporates their comments and recommendations. The Authority is asked to endorse those recommendations as set out in section 4,

2. Background

- 2.1 In considering the level and nature of reserves we have taken into consideration the various legislative and regulatory frameworks, namely the Financial Reporting Manual issued by the Treasury, legislation specific to the Authority as a Non Departmental Public Body, and discussions held with the DfT as our sponsoring body.
- 2.2 The 2010-11 budget report to the BTPA meeting on 9 December 2009 identified an anomaly in the funding of capital expenditure. This caused a discussion as to the nature and extent of the fund's reserves and the constraints if any as to their use.

3. Analysis

3.1 The summary of Reserves as at 31 March 2010 is below:

| Summary of Reserves at 31 March 2010 | |
|---------------------------------------------|------------------|
| | <u>£'000</u> |
| PSA Funded Reserves: | |
| Distributable Reserve (debit balance) | (6,138) |
| Contingency Reserve | 1,800 |
| Cashflow Advances: | |
| Capital Financing Reserve | 53,360 |
| Specific Grant Reserve | 5,003 |
| Working Capital Reserve | 6,500 |
| Notional IFRS Balances: | |
| Fixed Asset Revaluation Reserve | 3,424 |
| FRS17 Pension Reserve | (469,000) |
| IFRS Adjustment Reserve | (2,653) |
| | (407,704) |

The history of these reserves since the Authority was established is at Appendix A.

3.2 **Description of the Reserves.** There are three types of reserve shown on the balance sheet and at Appendix A. Their nomenclature according to advice from the NAO is special to the British Transport Police Fund. It has arisen because of the origin of the balances and it can be helpful in understanding the nature and extent of the reserves. The three groups are

- 'Police Service Agreement (PSA) funded reserve';
- 'Cashflow advances' and
- 'Statutory Accounting requirements'

3.3 **PSA Funded Reserve.** This reserve arises from PSA income in excess of expenditure, paid by core and enhanced PSA holders. Therefore the accumulated balance represents the accumulated surpluses / deficits since the creation of the Authority, including year end financial accounting adjustments. It can be used, provided there is an approved valid business case at the direction of the Authority and the Force in accordance with its delegations. This reserve is shown as:

3.3.1. **Distributable Reserve.** Normally this would be a small positive sum arising from the excess of income over expenditure over the year. It could be held, used to defray annual operating costs or transferred to the contingency reserve. It shows a negative balance of £6,138k which is after charging the doubtful debt provision resulting from the Judicial Review. This figure is balanced by the loan from the DfT and will be written down as action is taken to either recover the outstanding debt or demonstrate that the debt is irrecoverable. The loan then is treated as a grant. Once this action is taken and reflected in the PSA charges reserves, it should return to a small positive balance. This should be part of an income and expenditure reserve.

3.3.2 **Contingency Reserve.** The Contingency Reserve was set up with the agreement of HM Treasury and the DfT in 2007-08 to provide for unexpected events, such as major incidents and crimes, and to reduce the impact of these events on a single year's budget. A ceiling was agreed for the Reserve of £3m uplifted by the Retail Price Index (RPI). Initially, £1.4m was put into this reserve. The contingency reserve should be sized to reflect the financial impact of risks arising from operations and the conduct of business. This reserve should be held as part of the income and expenditure reserve.

3.3.3 **PSA Charges Reserve.** This shows a balance of zero and records the conversion of DfT loan into grant in order to pay off the irrecoverable debt from the TOCs arising from the Judicial Review.

3.4 **"Cash flow" Advances.** This consists of:

3.4.1 **Capital Financing Reserve.** This holds money paid by the DfT to fund the Capital Programme. This has grown through the life of the Authority. The theory is that the Authority receives cash to fund a capital project. The value of the project is depreciated over time. The depreciation is paid for by the Train Operating Companies (TOCs) and Network Rail (NR) in their PSA charge. The cash arising from this should be returned to the DfT or used with the agreement of the DfT as a

contribution to next year's capital programme. This has not occurred hence the increase shown in Annex A. These cash advances made by the DfT for capital expenditure are effectively a loan. This is confirmed in the Financial Memorandum included in the BTPA Governance Statement that states that capital expenditure should be recovered from the railway industry through PSA charges over the life of the asset. Director General (DG) Funding and Estates DfT has been briefed on this and has directed her staff to identify the options for its use.¹ It is currently not available to the Authority.

3.4.2 Specific Grant Reserve. The Specific Grant Reserve is credited with specific grants received for specific capital projects funded by the DfT or Home Office. This reserve is written down year by year to match the depreciation charged on the assets acquired as a result of these specific projects. The assets acquired are therefore fully funded by the grant received from the government department and are not paid for by the TOCs and NR. This reserve is correctly accounted for and the balance of £5,003k cannot be redeployed.

3.4.3. Working Capital. This account was established because of the BTPA could not cover its short term cash requirement in 2004/05. This required the Authority to draw a cash advance from the DfT as shown in Annex A. The DfT do not expect this advance to be repaid. The authority should however establish its working capital requirement to ensure that it can cover its short term cash requirement. This reserve should be held in the income and expenditure reserve.

3.5 "Accounting Requirements". This reserve represents specific adjustments made as a result of published accounting conventions which do not trigger a charge to the PSA holders. There are three "reserves" in this group:

3.5.1 Pensions Reserve. The Pensions Reserve, an International Financial Reporting Standards (IFRS) accounting requirement, reflects the notional liability of the BTPA for employees' long term pension entitlements that are not

¹ Meeting CE BTPA/ DG Resources and Estates 25 Jun 10

currently funded, hence it is negative. It is balanced within the BTPA Balance Sheet by a provision separately identified for pension liabilities. It is not realisable.

3.5.2 **Fixed Asset Revaluation Reserve.** The Revaluation Reserve is an IFRS accounting adjustment that reflects the revaluation of assets at the year end in accordance with the requirements. Where appropriate, the value of the assets in the Balance Sheet is increased to reflect current price levels and this is balanced by the entry in the Revaluation Reserve. The balance in this account is not available for any other purpose.

3.5.3 **IFRS Adjustment Reserve.** The IFRS Reserve is negative and arises because of an accounting adjustment related to accrued holiday pay. The IFRS requirement is that all leave entitlement that has not been taken should be shown as a creditor outstanding at the year end.² In order to avoid distorting the Income and Expenditure Account, the creditor provision is not charged against that account but is charged to the IFRS Adjustment Reserve account and separately identified within the Statement of Reserves. This is an erroneous distinction in financial reporting terms but it aids understanding. The Audit Committee agreed that this should be subsumed within the General Reserve. This reserve is not realisable. This reserve should be held as part of the income and expenditure reserve.

² The leave year for BTPA officers and staff is the calendar year and the IFRS calculation assumes that one quarter of the annual entitlement should have been taken between 1 January and 31 March. In practice, most people will focus leave arrangements over the summer time and therefore have a significant amount of accrued leave outstanding at 31 March. The leave entitlement is most likely to be taken as time off and does not result in an actual payment being made. However, the IFRS requirement does not recognise that. The balance of creditors outstanding therefore includes provision for this holiday entitlement.

3.6 **Recommended Grouping of Reserves.** The advice we have received from the National Audit Office is that to be compliant with the Financial Reporting Manual is that we should group our “reserves” as follows:

- **Income and Expenditure Reserve (a general reserve)**

This consists of:

- Distributable Reserve (including IFRS reserve)
 - Contingency Reserve
 - PSA Charges Reserves
 - Capital Financing Reserve
 - Restricted Reserve
 - Working Capital Reserve
- **Government Grant Reserve**
 - **Revaluation Reserve**
 - **Pension Reserve**

3.7 This presentation is shown at Appendix B. The analysis of the income and expenditure reserve shows a surplus of £1,738k together with the contingency reserve of £1,800k. These are available for use by the Authority once the amounts charged for the bad debt provision have been released and funded elsewhere (through cash receipts from the PSA holders or through grant in aid from the DfT).

4. Recommendations

The Authority should endorse the recommendations made by the Audit Committee, as follows:

- 4.1 The nature and extent of the Reserves in this report reflect the contents of the Statement of Accounts for financial year 2009/10 (Paragraph 3.1 - Appendix A).
- 4.2 The IFRS Reserve should be subsumed into the Distributable Reserve in the 2009/10 accounts.

- 4.3 The Distributable Reserve should be a constituent of an Income and Expenditure Reserve (Para 3.3.1).
- 4.4 The Contingency Reserve should be sized to reflect the financial impact of risks arising from the operation of the Authority and Force and should be a constituent part of the Income and Expenditure Reserve (Para 3.3.2).
- 4.5 The surplus in the Capital Financing Reserve should be treated in accordance with the guidance once received which has been sought from the DG Reserves and Estates DfT (Para 3.4.1). This should be a constituent part of the Income and Expenditure Reserve.
- 4.6 The amount of Working Capital required by the Authority should be determined. Once determined this should be held in the Income and Expenditure Reserve (Para 3.4.3).
- 4.7 The Authority should agree how best to state its reserves in the accounts with effect from 1 April 2010. Appendix B is compliant with the Financial Reporting Memorandum (Para 3.6) and it is the recommended disclosure.
- 4.8 The reserves available to the Authority are a surplus of Income over Expenditure of £1.738k and £1.8k in the Contingency Fund. (Para 3.7, Appendix B)