Financial Sustainability Assessment – Monmouthshire County Council

Audit year: 2020-21

Month/Year issued: July 2021

Document reference: 2503A2021-22

Contents

What we looked at and why

1 We undertook this assessment as financial sustainability continues to be a risk to councils putting in place proper arrangements to secure value for money in the use of resources. In part, this was informed by the experiences of some councils in England, our knowledge of the financial situation in councils in Wales, and the general trend of decreasing resources for local government combined with rising demand for some services. We undertook a similar project in 2019-20, before the COVID-19 pandemic.

2 Our 2020-21 assessment on councils' financial sustainability was in two phases. Phase 1 was a baseline assessment of the initial impact of COVID-19 on local councils' financial position. Phase 1 drew on: the year-end position for 2019-20; the position at the end of quarter 1 for 2020-21; and projections for quarter 2 for 2020-21. Following Phase 1, in October 2020 we published a national summary report – **Financial Sustainability of Local Government as a result of the COVID-19 Pandemic**[1]. We found that councils and the Welsh Government have worked well together to mitigate the impact of the pandemic to date, but the future sustainability of the sector is an ongoing challenge.

3 The pandemic has had an immediate and profound effect on public sector finances as a whole and, as a consequence, on councils' financial position. The summary report set a high-level baseline position, including the reserves position of local councils before the pandemic. It also set out the initial financial implications of the pandemic for local councils and the scale of the anticipated challenge going forward.

4 This report concludes phase 2 of our financial sustainability assessment work during 2020-21. As part of this we are producing a local report for each of the 22 principal councils in Wales.

5 We undertook this assessment during February 2021 and March 2021.

[1] Audit Wales, Financial Sustainability of Local Government as a Result of the COVID-19 Pandemic, October 2020.

Proposals for improvement

Exhibit 1: proposals for improvement

The table below sets out the proposals for improvement that we have identified following this review.

Proposals for improvement	
P1	To ensure its Medium Term Financial Plan predicts future funding requirements as accurately as possible, the Council should: • regularly review its future cost pressure estimates to ensure they are reasonable and reflect recent levels of cost pressures.
P2	To bridge its estimated future funding gap and contribute to strengthening its financial sustainability the Council should: • develop and deliver a programme of sustainable planned savings over the medium term.

The Council has a good understanding of its financial position, but that position is challenging with significant expenditure pressures, low reserve balances and savings becoming more difficult to achieve

The immediate impact of COVID-19 on the Council's financial sustainability has been mitigated by additional Welsh Government funding

6 This section sets out the impact that COVID-19 has had to date on the Council's financial position and the extent to which this has been mitigated by additional funding from the Welsh Government.

What we found

7 The Council estimates that the pandemic will have cost it £19.6 million in 2020-21. This is made up of £11.3 million of additional expenditure and income losses of £8.4 million.

8 The Council anticipates that these costs will be funded in full by the Welsh Government.

9 In June 2020, the Council assessed the financial risks it faced from the pandemic. This included an assessment of the Council's reserves and the possible reprioritising of reserves to meet any COVID-19-related pressures not covered by Welsh Government funding. The Council continues to review the risks and these inform the regular budget monitoring reports as well as its Strategic Risk Register. The Council has also increased the frequency of its budget monitoring reports to ensure elected members receive timely information on emerging financial issues.

10 The Council has modelled income loss pressures for 2021-22 caused by the pandemic but has no plans to reduce its fees and charges. Final budget papers for 2021-22 show an average increase in fees and charges of 2.5% but this varies by service and is based on officers' judgement of what they think the market can afford.

11 The Council has also decided to retain its council tax collection rate at 99% for 2021-22. The Council considers this a reasonable assumption based on a review of historic rates and collection rates during 2020-21.

Exhibit 2: the cost to the Council of COVID-19 over 2020-21[2]

The table below shows the Council's estimated additional expenditure and lost income over 2020-21, as a result of COVID-19, and how much of this was mitigated by extra funding from the Welsh Government.

The additional amount the Council estimates it will have spent as a result of COVID-19 over 2020-21.	£11.3 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£8.4 million
The amount of additional funding the Council estimates it will receive from the Welsh Government over 2020-21 to mitigate the impact of COVID-19: • Hardship fund – £19.6 million • Other COVID-19-related grants – £3.1 million	£22.7 million
The cost to the Council of COVID-19 over 2020-21, after extra funding from the Welsh Government is taken into account.	£0

The Council can identify its medium-term funding gap, but challenges remain in closing it and the Council recognises the need for medium-term savings plans

Why strategic financial planning is important

12 A clear and robust financial strategy is important to identify the likely level of funding available to a council, as well as the anticipated level of demand for, and cost of, providing services. Given the recent and anticipated funding pressures facing all councils, it is also important to identify how it intends to respond to those pressures, and particularly how they will meet projected funding gaps.

[2] Source: 2020-21 Outturn report

What we found

13 Last year we found that the Council did not yet have a financial strategy to support financial resilience and sustainability over the medium term.

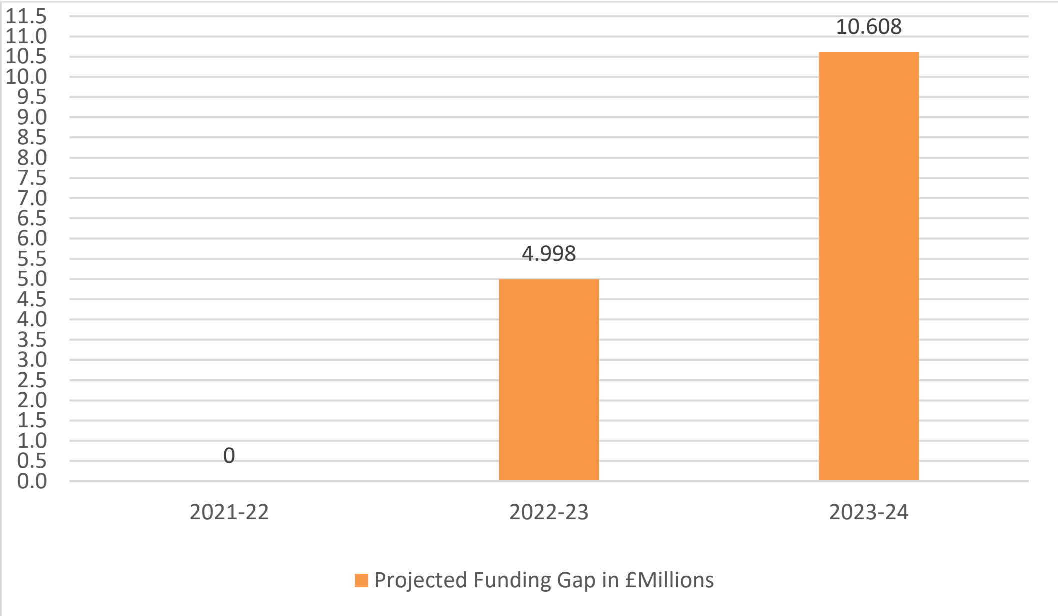
14 The latest Medium Term Financial Plan (MTFP) and budget papers contain detailed forecasts for financial pressures in 2021-22, but only limited cost pressures have been identified for the remaining three years of the MTFP. The MTFP includes a provision of £5 million a year for unidentified pressures from 2022-23. This estimate is based on historic levels of pressures and has been increased from £2.5 million. However, in recent years, cost pressures identified as part of the budget setting process have often exceeded £5 million, ranging from £5.6 million in the 2018-19 budget to £10.3 million in the 2021-22 budget. It would be prudent, therefore, for the Council to review this estimate each year to ensure it reflects recent levels of cost pressures.

15 The Council undertakes more detailed work to identify the extent of the pressures closer to the year in question and through the annual budget process. Pressures that cannot be managed within the service are considered as part of the budget setting process and undergo challenge from both officers and members.

16 **Exhibit 3** shows that the Council has no forecast funding gap for 2021-22 (once planned savings are considered) but there remains a £5 million gap for 2022-23 and £10.6 million for 2023-24. These figures are cumulative, so assuming the Council identifies £5 million of recurring savings for 2022-23, this will also reduce the funding gap for 2023-24 by £5 million.

Exhibit 3: the Council has a total projected funding gap for the three years 2021-22 to 2023-24 of £15.6 million

This graph shows the funding gap that the Council has identified for the following three years[3].



17 To inform financial planning and identify their projected funding gaps, all councils make assumptions about factors that will impact on the amount of funding they will have available in future years. The Council's assumptions in its MTFS provide a balanced forecast at the time of its publication when compared with the assumptions made by all Councils across Wales.

18 The Council regularly reviews and challenges the assumptions in its MTFP. Officers explain the reasoning behind the assumptions to elected members. The funding gap may increase if cost pressures in future years exceed the £5 million estimate included in the MTFP.

19 The Council has already closed the funding gap for 2021-22 as part of the budget process. It achieved this through:

- 3.89% increase in Council Tax;
- better than expected settlement from the Welsh Government; and
- £4.7 million of savings to be achieved in the year.

20 However, the MTFP does not set out how the Council plans to close the funding gap beyond 2021-22. The Council recognises the need to develop a balanced

[3] Source: Final Revenue and Capital Budget Proposals presented to the Council on 11 March 2021

MTFP and acknowledges this in the 2021-22 budget papers. However, it faces challenges in doing so. Key barriers and risks include:

- uncertainty over medium-term funding from the Welsh Government, due to a lack of indicative settlement figures and changes to COVID-19 funding. The Welsh Government's COVID-19 Hardship Fund is due to end on 30 September 2021, at which point the Council will no longer be able to recoup ongoing cost pressures and income losses linked to the pandemic;
- service pressures – both existing and newly emerging pressures brought about by the pandemic; and
- the impact of the local government election cycle on financial decision making.

21 Following several years of budget cuts and efficiency savings, it is becoming increasingly difficult for the Council to identify and implement savings on an annual basis. The Council recognises the need to develop medium-term savings plans which provide sufficient lead-in time and the Senior Leadership Team aims to develop longer-term savings plans over the coming years. This will provide a more sustainable approach to closing future budget gaps but will require members to take longer-term decisions.

The Council has recently increased its reserves balances after a period of decline, but levels remain low and current use of capital receipts to fund revenue expenditure is unsustainable in the long term

Why sustainable management of reserves is important

22 Healthy levels of usable reserves are an important safety net to support financial sustainability. As well as being available to fund unexpected funding pressures, usable reserves can also be an important funding source to support 'invest to save' initiatives designed to reduce the ongoing cost of providing services. Councils that show a pattern of unplanned use of reserves to plug gaps in their revenue budget that result in reductions of reserve balances reduce their resilience to fund unforeseen budget pressures in future years.

What we found

23 Last year, we found that the Council's General Fund was in line with its reserves strategy, but usable reserves overall were comparatively low and continued to decline.

24 **Exhibit 4** below shows a pattern of slowly decreasing usable reserves until the end of 2019-20 when the Council added a £1.8 million year-end surplus to its Council Fund. This was a prudent approach given the emerging pandemic and the potential need to draw on reserves in 2020-21 to fund COVID-related expenditure.

25 Over recent years, the Council's level of usable reserves as a proportion of its net cost of services has varied between the third and fifth lowest in Wales.

Exhibit 4: amount of reserves versus annual budget

This exhibit shows the amount of usable reserves the Council had during 2020-21 and the previous four years as a proportion of the net cost of the services the Council delivers.

	2016-17	2017-18	2018-19	2019-20	2020-21
Net Cost of Services in £ millions [4]	147.0	149.2	153.9	158.8	174.0
Total Usable Reserves in £ millions [5]	15.2	14.7	13.5	14.9[6]	18.9
Total Usable Reserves as a percentage of the net cost of services [7]	10.3%	9.9%	8.8%	9.4%	10.9%
Comparison with the other councils of Wales	18th	20th	20th	19th	

26 The Council indicated that it might need to draw on the Council Fund to balance its budget in 2020-21 if mitigating budgetary actions were insufficient to address forecast overspends. However, the improved forecast position at the end of December 2020 meant this was no longer necessary. At the end of December 2020, usable earmarked reserves were forecast to reduce by £849,000 during 2020-21. However, the Council is proposing to use its 2020-21 year-end surplus to further boost its usable reserves.

27 Similarly, draft budget proposals for 2021-22 initially outlined planned use of £748,000 of the Council Fund. But following adjustments to the draft proposals, the Council no longer needs to draw on the Fund to balance the budget. The Council plans to draw on earmarked reserves in 2021-22.

28 Although the capital receipts reserve is not included in our definition of usable reserves, its use to fund revenue expenditure is worthy of comment. At the end of 2019-20, the capital receipts reserve balance was £3.2 million (down from £4.6

[4] Value used is the net cost of services charged to the general fund from the Expenditure Funding Analysis, less any Housing Revenue Account cost of services, plus precepts, levies and debt interest. Source: Statement of Accounts and 2020-21 outturn report

[5] By usable reserves we mean the total general fund balance, together with earmarked reserves that councils are not legally prevented from redirecting to use for another purpose. Source: Statement of Accounts and 2020-21 outturn report

[6] The £1.4 million increase to total usable reserves in 2019-20 includes the £1.8 million year-end surplus added to the Council Fund less £0.4 million of earmarked reserves used in-year.

[7] Audit Wales calculation.

million in 2018-19). The Council planned to use £2.1 million of capital receipts in 2020-21 and a further £2.2 million in 2021-22 through the Welsh Government's directive on flexible use of capital receipts. However, reduced service activity during the year meant that the Council instead used £1 million of capital receipts. The Council forecasts the capital receipts reserve balance will be £9.2 million at the end of 2020-21, once new receipts are also accounted for. The directive allows the Council to use capital receipts to fund eligible revenue costs such as those incurred in the transformation of services. Although this helps relieve the pressure on revenue budgets in the short term, it impacts on the Council's ability to fund capital projects over the medium to long term. Continued use of the capital receipts reserve in this way could therefore result in the Council needing to borrow more extensively to fund future capital projects.

29 The Council recognises that its usable reserves are at low levels and that use of these reserves – and the capital receipts reserve – is not sustainable long term. It has made this clear in budget reports to members, referencing the 'historically low levels' of reserves.

30 The Council told us that it finds it challenging to build up its reserves whilst continuing to deliver services. The latest budget monitoring report to members recommends that any year-end surplus be used to provide Cabinet with some headroom for policy choices, which could include strengthening the Council's reserves to meet future financial challenges. This follows last year's decision to add the 2019-20 year-end surplus to the Council Fund reserve. Continuing to increase its usable reserves will put the Council in a stronger position to meet future financial challenges. Particularly in the context of the forecast budget gaps in the MTFP and uncertainty over Welsh Government funding for COVID-related costs over the medium term.

31 The Council plans to review its existing reserve strategy over the next year to ensure it is suitable for the medium to long term. This is likely to focus on reviewing earmarked reserves to ensure they correlate to specific risks and are used as intended. Any potential year-end surplus available to supplement reserves is therefore likely to increase earmarked reserves levels rather than the Council Fund.

The Council continues to balance its budget through in-year actions, although it continues to experience significant cost pressures and overspends in certain service areas

Why accurately forecasting expenditure is important

32 It is important that overspending and underspending are kept under control and that actual expenditure is as close to the levels planned as possible. A council that is unable to accurately forecast and plan expenditure runs the risk of creating unforeseen financial pressures that may compromise the ability to set a balanced

budget. Significant patterns of underspending may be reducing the ability of a council to deliver its key objectives or meet its statutory responsibilities.

What we found

33 Last year, we found that while the Council had underspent against its budget in recent years, significant demand-led budget pressures were placing considerable strain on future budgets.

34 Since then, the Council achieved a £1.8 million (1.1%) underspend in 2019-20. During the year, the Council received a £2.3 million one-off VAT receipt relating to exempt leisure service income. Further actions delivered by the Council included:

- flexible use of capital receipts;
- delivery of additional in-year savings;
- underspends in corporate services helping to offset overspends in services experiencing more severe cost pressures;
- reducing non-essential spending; and
- vacancy management.

35 The Council's month-9 budget monitoring report forecasts a £142,000 underspend in 2020-21 once COVID-related funding is accounted for. This has also been achieved using the techniques above (other than the VAT refund).

36 However, at the time of our fieldwork, the Council had received notification from the Welsh Government of additional COVID-19-related grant funding. This has resulted in a year-end surplus of £4.1 million. The Council proposes to use this surplus to replenish earmarked reserves to provide it with greater financial resilience.

Exhibit 5: amount of overspend/underspend relative to total net revenue budget

The following exhibit shows the amount of overspend or underspend for the Council's overall net revenue budget for the last five years.

	2016-17	2017-18	2018-19	2019-20	2020-21
Original Net revenue budget £ millions [8]	148.7	152.1	157.8	161.8	170.4
Actual Net Revenue Outturn [9]	147.8	151.5	157.8	160.0	166.3
Amount of overall surplus/overspend [10]	0.9	0.6	0.05	1.8	4.1
Percentage difference from net revenue budget	0.6%	0.4%	0.03%	1.1%	2.4%

[8] Source: Council Outturn reports for 2016-17 to 2020-21

[9] Source: Council Outturn reports for 2016-17 to 2020-21

[10] Audit Wales calculation.

37 Many cost pressures and overspends in 2020-21 are related to additional expenditure or lost income caused by COVID-19. However, some Council services have recurring overspends which pre-date the pandemic. These include:

- Children’s Services, particularly costs relating to looked after children
- Additional learning needs
- Passenger transport
- Waste services

38 The Council is exploring ways to manage some of these cost pressures. For example, a review of school transport is underway, and the waste service is applying several service changes. Children’s Services have implemented several measures to help manage demand within Looked after Children and the Council reports it is starting to see early signs of the impact of these initiatives, with the number of looked after children starting to stabilise during 2020-21.

The COVID-19 pandemic has affected the Council’s ability to achieve its planned savings for 2020-21

Why the ability to identify and deliver savings plans is important

39 The ability to identify areas where specific financial savings can be made, and to subsequently make those savings, is a key aspect of ensuring ongoing financial sustainability against a backdrop of increasing financial pressures. Where savings plans are not delivered this can result in overspends that require the use of limited reserves whilst increasing the level of savings required in future years to compensate for this. Where savings plans are not delivered and service areas are required to make unplanned savings, this increases the risk either of savings not being aligned to the Council’s priorities, or of ‘short-term’ solutions that are not sustainable over the medium term.

What we found

40 Last year, we found that the Council had a variable record of delivering planned savings, which can contribute to in-year financial pressures.

41 **Exhibit 6** shows that the Council achieved 84% of planned savings in 2019-20.

42 The Council had £4.9 million of planned savings in 2020-21 but the pandemic has affected delivery of some savings proposals. The Council forecasts that it will deliver 85% (£4.2 million) of the total planned savings.

43 Of the £0.7 million undelivered savings, the Council estimates that £0.6 million is related to the impact of COVID-19.

Exhibit 6: savings delivered as a percentage of planned savings

The following exhibit sets out how much money the Council intended to save from its savings plans between 2016-17 and 2020-21 and how much of this it actually saved.

	2016-17	2017-18	2018-19	2019-20	2020-21
Total planned savings in £ millions [11]	3.7	5.3	5.1	6.4	4.9
Planned savings achieved in £ millions [12]	2.4	4.9	4.1	5.4	4.2
Planned savings not achieved in £ millions	1.3	0.4	1.0	1.1	0.7
Percentage of savings achieved	66%	93%	81%	84%	85%

Although the Council's liquidity position is low, the Council believes its cash flow is sufficient to meet its liabilities

Why the Council's liquidity position is important

44 Why gauging current assets to current liabilities (liquidity) is important:

- it is an indicator of how a council manages its short-term finances.
- while it is commonly used to examine whether organisations are able to pay their debts in the short term, this is unlikely to be a risk for councils given their ability to take short-term borrowing. It does also, however, act as an indicator of how a council manages its short-term finances.
- councils with low liquidity ratios should ensure they have arrangements in place to meet their liabilities.
- there may be additional costs for councils that rely on short-term borrowing to pay debts.
- councils with very high liquidity ratios should consider whether they are managing their current assets in the most effective way.

What we found

45 The Council has a trend of decreasing liquidity over recent years as its current liabilities have increased.

46 **Exhibit 7** below, shows that the Council's current liabilities increased by £70.6 million (128%) between 2015-16 and 2019-20. Over the same period, the

[11] Source: Council's revenue outturn statements

[12] Source: Council's revenue outturn statements

Council's current assets increased by £6.4 million (12%). As a result, the Council's working capital ratio has fallen from 1 to 0.5 and is the second lowest in Wales.

47 The projected liquidity ratio for 2020-21 is 0.4.

48 The reduction in working capital ratio over the last few years has been primarily due to a tactical treasury strategy to favour short term borrowing or utilising internal resources over long term borrowing. This strategy is expected to remain in the near term until such time that capital investment plans crystallise and/or market conditions change. The Council does not see its liquidity position as a key risk as regular cash receipts ensure it is able to meet its current liabilities.

Exhibit 7: working capital ratio 2015-16 to 2020-21

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 estimate
Current Assets [13]	52.7	29.7	40.9	53.7	59.1	55.7
Current Liabilities [14]	55.3	52.3	91.7	105.1	125.9	125.2
Working Capital Ratio	1.0	0.6	0.4	0.5	0.5	0.4
Average working Capital Ratio across all Welsh councils	16th	20th	21st	21st	21st	

[13] Current Assets includes: Short Term Investments; Assets held for sale; Inventories; Short Term Debtors; and Cash and equivalent. Source: 2015-16 – 2019-20: Council's Statement of Accounts; 2020-21: provided by the Council

[14] Current Liabilities includes: Short Term Borrowing; Short Term Creditors; and Provisions due in one year. Source: 2015-16 – 2019-20: Council's Statement of Accounts; 2020-21: provided by the Council

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We welcome correspondence and telephone calls in Welsh and English. Rydym yn croesawu gohebiaeth a galwadau ffôn yn Gymraeg a Saesneg.