WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

Archwilydd Cyffredinol Cymru
Auditor General for Wales

Financial Sustainability Assessment – **Monmouthshire County Council**

Audit year: 2019-20

Date issued: August 2020

Document reference: 1968A2020-21

Contents

Increasing cost pressures and variable levels of savings delivery are impacting the Council's financial sustainability and, although it is taking in-year action to manage the situation, this approach is not sustainable over the longer term.

Summary report

Summary

What we reviewed and why

1 The project sought to assess the sustainability of councils' short to medium-term financial position.

2 This included a focus on the financial strategy of each council as well as reviewing financial 'indicators' of each council's financial position in relation to:

- Performance against budget
- Delivery of savings plans
- Use of reserves
- Council tax
- Borrowing

Exhibit 1: about the Council

This exhibit sets out some background information on the Council's net revenue budget, the number of staff it employs and the value of its fixed assets

The Council's net revenue budget for 2019-20 was £161.8m[1]

The Council employs around 4,500 people[2]

The Council's fixed assets as at 31 March 2019 were £323m[3]

3 We undertook this assessment because we identified financial sustainability as 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 recent 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.

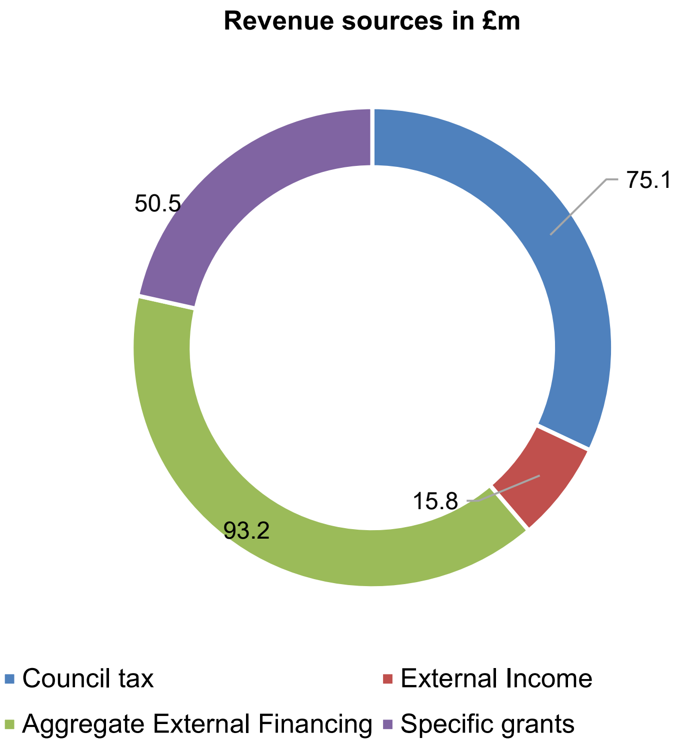
[1] Source: Council tax and budget report to Council, March 2019

[2] Source: Monmouthshire County Council website

[3] Source: Monmouthshire County Council 2018-19 Statement of Accounts

Exhibit 2: the Council's sources of revenue

The pie chart below shows how much money the Council received from different funding sources during 2018-19[4]



4 We undertook the review during the period November 2019 to January 2020.

What we found

5 Overall we found that increasing cost pressures and variable levels of savings delivery are impacting the Council's financial sustainability and, although it is taking in-year action to manage the situation, this approach is not sustainable over the longer term.

We reached this conclusion because:

- the Council does not yet have a financial strategy to support financial resilience and sustainability over the medium term;
- while the Council has underspent against its overall budget in recent years, significant demand-led budget pressures are resulting in overspends in some service areas;
- the Council has a variable record of delivering planned savings, which can contribute to in-year financial pressures;

[4] Source: Council self-assessment

- the Council's General Fund is in line with its reserves strategy but usable reserves overall are comparatively low and continue to decline;
- council tax accounts for the largest proportion of the Council's income and it has strong in-year collection rates; and
- in pursuing its Commercial Strategy, the Council should ensure that it continues to manage the associated risks of any additional borrowing.

Detailed report

Increasing cost pressures and variable levels of savings delivery are impacting the Council's financial sustainability and, although it is taking in-year action to manage the situation, this approach is not sustainable over the longer term

The Council does not yet have a financial strategy to support financial resilience and sustainability over the medium term

Why strategic financial planning is important

6 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.

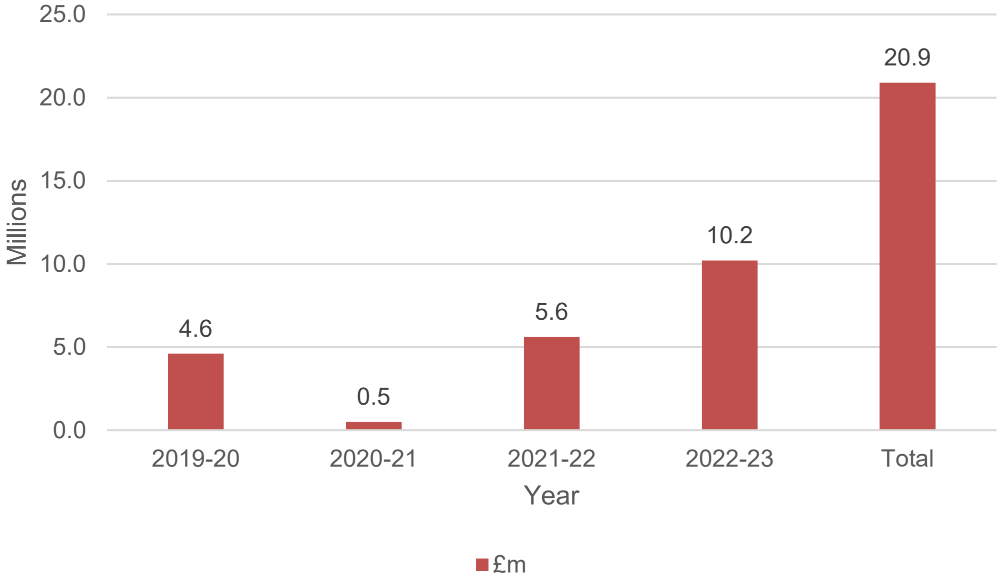
What we found

7 We found that the Council does not yet have a financial strategy to support financial resilience and sustainability over the medium term. We reached this conclusion because:

- the Council's Medium Term Financial Plan (MTFP) approved by Cabinet in September 2019 sets out a projected funding gap of £21 million over the period 2020-21 to 2023-24. It does not, however, demonstrate how it will close the forecast shortfall.

Exhibit 4: projected funding gap

The following graph shows the funding gap that the Council identified for this year, and the following three years.[5]



- the funding gaps in Exhibit 4 are cumulative and reflect the Council's estimates at a position in time. For example, the 2019-20 shortfall of £4.6 million was based on modelled assumptions undertaken in Autumn 2018 to inform the MTFP. Since then, reports to Cabinet show there would be no funding gap for 2019-20. In addition, many savings identified by the Council are cumulative and so will roll forward, reducing the funding gap for subsequent years.
- the Council has traditionally closed identified annual budget gaps through a combination of efficiency savings, council tax rises, and increased income from fees and charges. The MTFP acknowledges that the Council's traditional approach to savings, ie service managers identifying savings on a typically annual basis, is making a 'diminishing contribution'.
- the Council recognises the need to address the budget gap over the medium term and the MTFP suggests that the 2020-21 budget process will aim to identify savings that contribute to the management of the projected financial gap in the MTFP. The Council also has a variable record of delivering its planned savings.
- the Council's provisional RSG settlement from Welsh Government for 2020-21 is 3%, equating to a £2.9 million cash increase on the 2018-19 settlement. However, this includes amounts previously provided by Welsh Government, such as specific grants for teacher pay and pensions and social services. The provisional settlement has reduced the Council's projected funding gap for 2020-21 from £1.2 milliom to £0.5 million. The

[5] Source: 2019-20 funding gap: Medium Term Financial Plan 2019/20 – 2022/23. 2020-21 to 2022-23 funding gaps: Revenue Budget Summary documents presented to Cabinet 19th February 2020

Council is currently exploring options to bring forward savings and reduce cost pressures to close this remaining gap.

- the MTFP suggests that expenditure reductions of around 15.5% would be required from all services to address the total £21 million forecast financial gap (these calculations are based on assumptions of future funding as multi-year settlements are not provided by Welsh Government). Identifying and achieving this level of savings will be challenging in the context of demand-led cost pressures and the need in recent years to identify additional in-year savings to contain overspends.
- the Council expects income from commercial and investment activities to play a larger role in addressing future budget pressures. The Council has also reviewed its approach to setting fees and charges as part of its Commercial Strategy. The draft budget proposals for 2020-21 include an additional £1 million income resulting from new charges or increases to existing fees and charges. However, the MTFP does not indicate to what extent these approaches might help close the projected funding gap over the medium term.

While the Council has underspent against its overall budget in recent years, significant demand-led budget pressures are resulting in overspends in some service areas

Why accurately forecasting expenditure is important

8 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

9 We found that while the Council has underspent against its budget in recent years, significant demand-led budget pressures are placing considerable strainon future budgets.

10 We reached this conclusion because:

- in the past two years the Council has underspent against its overall budget but is forecasting a significant overspend in the current year, as set out in Exhibit 5.

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 two years and the year to date as at October 2019.

	Original Budget net Revenue budget	Actual Outturn net Revenue budget	Amount of overall surplus/overspend	Percentage difference from net Revenue budget
2017-18[6]	£152.1m	£151.5m	£652k underspend	0.4% underspend
2018-19	£157.812m	£157.763m	£49k underspend	0.03% underspend
2019-20 as of end of October 2019[7]	£161.8m	£165.8m	£4m overspend	2.5% overspend

- the underspend positions in both 2017-18 and 2018-19 have been achieved via the delivery of additional in-year savings and utilising underspends in corporate services to offset overspends in areas such as looked after children, additional learning needs and operations.
- however, the forecast position as at October 2019 has required the Council to take further action to manage the position. Measures include:
  - identifying additional in-year savings across the Council;
  - reducing non-essential spend;
  - vacancy management;
  - use of one-off windfalls, such as the anticipated refund of overpaid VAT in relation to sporting services, following the Ealing ruling; and
  - exploring the flexible use of capital receipts.
- Children's Services accounts for £2.8 million of the £4 million forecast overspend in 2019-20. The Council reports that this is due to large increases in the number of looked after children. Other cost pressures impacting on the forecast 2019-20 year-end variance include:
  - Children with additional learning needs;
  - Adult social care;
  - Community care;
  - Car parking;
  - Passenger transport; and
  - Monlife (leisure and outdoor activity provision).

[6] 2017-18 and 2018-19 data taken from Revenue Budget Out-Turn Reports presented to Cabinet each year

[7] 2019-20 data taken from revenue and capital monitoring report to Monmouthshire County Council's Cabinet in January 2020. This reflects the forecast overspend as at October 2019 and does not take into account the impact of subsequent actions taken to manage the overspend.

- whilst it is positive that the Council has taken corrective action to manage the 2019-20 forecast position without using reserves, and it will need to remain responsive to evolving demand pressures as they arise, it will become increasingly difficult for the Council to identify sustainable ways to fund future cost pressures.

The Council has a variable record of delivering planned savings, which can contribute to in-year financial pressures

Why the ability to identify and deliver savings plans is important

11 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

12 We found that the Council has a variable record of delivering planned savings, which can contribute to in-year financial pressures.

13 We reached this conclusion because:

- Exhibit 6 sets out that the Council achieved 81% of its planned savings in 2018-19.

Exhibit 6: savings delivered during 2018-19 as a percentage of planned savings

The following exhibit sets how much money the Council intended to save through planned savings during 2018-19 and how much of this it actually saved.[8]

£5.1m	£4.1m	£1.0m	81%
Total planned savings	Planned savings delivered	Planned savings not delivered	Percentage savings achieved

- 30% of the undelivered savings in 2018-19 related to the Social Care and Health and Children and Young People's directorates, areas already subject to growing demand-led pressures
- 93% of planned savings were achieved in 2017-18 and 66% in 2016-17.
- the Council forecasts that it will deliver 85% (£5.5 milllion) of total planned savings of £6.4 million in 2019-20. £408,000 are delayed and £586,000 deemed potentially unachievable.

[8] Source: Council self assessment

- in addition to the planned savings for 2019-20, services are also delivering additional savings identified in-year to manage the forecast overspends.
- the Council completes a risk assessment at each budget monitoring period to identify whether planned savings will be delivered in year. Revenue budget monitoring reports set out whether each saving is expected to be achieved. Savings classified as unachievable are generally replaced by alternative savings proposals or removed from base budgets in future years.

The Council's General Fund is in line with its reserves strategy but usable reserves overall are comparatively low and continue to decline

Why sustainable management of reserves is important

14 Healthy levels of usable reserves are an important safety net to support financial sustainability. As well as being available to fund unexpected funding pressures, useable reserves can also be an important funding source to support 'invest to save' initiatives designed to reduce the on-going 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

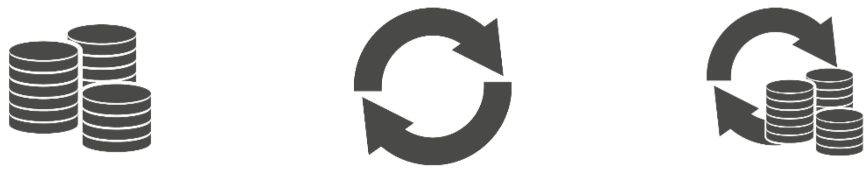
15 We found that the Council's general fund is in line with its reserves strategy but usable reserves overall are comparatively low and continue to decline.

16 We reached this conclusion because:

- in response to declining reserves levels, the Council introduced a reserves protocol in 2016. The protocol aims to ensure that reserves are only drawn on for specific purposes and following submission of a robust business case. The protocol is due to be reviewed as part of the 2020-21 budget and MTFP process.
- the Council sets a target range for general reserves of 4-6% of net revenue expenditure. It has no plans to use the general reserve to balance the annual budget during the life of the MTFP.
- Exhibit 7 below sets out the Council's level of usable reserves against its annual budget in 2018-19.

Exhibit 7: amount of reserves vs annual budget, 2018-19[9]

This exhibit shows the amount of usable reserves the Council had during 2018-19 compared with its net revenue budget for the same year.



£157.8m
Net Revenue Budget

£13.7m
Total Usable Reserves[10]

9%
Total Usable Reserves as a percentage of Net Revenue Budget

- at 31 March 2019 the Council held £13.7 million in usable reserves, comprising:
  – £7.11 million in General Fund (excluding school balances);
  – £6.61 million in usable earmarked revenue reserves balances.
- this does not include the Capital Receipts Reserve of £4.5 million and a negative Schools Reserve balance of £232,000, as these are allocated for specific use. The total of £13.7 million is a 5% reduction from 2017-18, when the Council held usable reserves of £14.5 million (10% of net revenue expenditure). The Council forecasts that usable reserves will fall further to £13.1 million by the end of 2019-20, equating to 8% of net revenue expenditure. Continuing use at these levels is unsustainable in the longer term.
- whilst levels of total usable reserves have fallen, the Council has maintained its General Fund at £7.1 million over this period. This places the General Fund between 4.4% and 4.6% of net revenue expenditure, at the lower end of the target range.
- the above balances do not include reserves which the Council holds on behalf of schools. At the end of 2018-19, school reserves stood at a deficit of £232,000. Fifteen schools ended the year in deficit and recovery plans are in place. At the end of October 2019 the school reserves deficit was expected to increase to £883,000 at the end of 2019-20. The Council is considering offering loans to schools as part of the draft 2020-21 budget proposals to help address the situation.

[9] Source: Council self assessment

[10] The Council defines usuable reserves as 'cash-backed reserves that can be used to fund future expenditure'. These include the Council Fund and earmarked reserves built up to meet known or predicted requirements and which have no restrictions on their usage.

Council tax accounts for the largest proportion of the Council’s income and it has strong in-year collection rates

Why council tax collection rates are important

17 Council tax is a key source of funding for councils in Wales. Failure to collect the amount of council tax due to the Council will result in less income. This in turn may increase the financial pressures on the Council and require it to make additional savings.

What we found

18 We found that council tax accounts for the largest proportion of the Council’s income and it has strong in-year collection rates.

19 We reached this conclusion because:

- the percentage of total gross revenue budget funded by council tax in 2019-20 is 32%. In comparison, the percentage of total gross revenue budget funded by Welsh Government’s Revenue Support Grant is 27%.
- council tax increased by 5.95% in 2019-20. Although, the MTFP assumes annual increases of 3.95% until 2022-23, in January 2020 Cabinet agreed to consult on a council tax increase of 4.95% for 2020-21.
- the Council recognises its high level of reliance on council tax income to fund its revenue budget and considers commercial activity as key to its future sustainability and reducing reliance on council tax over the longer term.
- the Council continues to have strong in-year council tax collection rates. Since 2016-17, these have remained steady at around 98%.
- the Council also has relatively low levels of council tax debt write offs: £0.2 million in 2018-19 and £0.15 million in 2017-18.

Exhibit 8: council tax collection rates

This exhibit shows the percentage of council tax due that the Council collected during 2018-19

Cash collected from Council Tax at 31 March 2019 was **£63.6m** (97.8%) against a collectable debit of **£64.9m**[11]

[11] Source: Stats Wales Council Tax Collection Rates in Wales: 2018-19

In pursuing its Commercial Strategy, the Council should ensure that it continues to manage the associated risks of any additional borrowing

Why maintaining sustainable levels of borrowing is important

20 Borrowing can be a valuable source of funding, for example to fund large scale capital projects such as new schools or leisure centres. However, the cost of repaying borrowing including interest costs can have a long-term impact on ongoing revenue budgets. Councils that fail to properly balance the benefits and costs of borrowing with their current and predicted revenue budgets risk reducing the amount of funding available for service delivery. Borrowing to fund commercial activity has the potential to generate additional income to fund council services, however, it can also bring significant risks that would be associated with any commercial activity.

What we found

21 We found that in pursuing its Commercial Strategy, the Council should ensure that it manages the associated risks of any additional borrowing.

22 We reached this conclusion because:

- the Council has £179.4 million of borrowings, of which £30.7 million (17%) has been used to fund commercial investments.
- the Council has a portfolio of investment properties including county farms, district shops and a solar farm. Net rental income from all investment properties was £1 million in 2018-19 compared to £0.6 million in 2017-18.
- included in the above investment property portfolio are the Council's two commercial investments: Castlegate Business Park and Newport Leisure Park, both acquired in 2018-19[12].
- whilst the Council's commercial ambitions present an opportunity to strengthen its financial sustainability through increased levels of income, it also exposes the Council to higher levels of risk.
- in July 2018, Cabinet approved the Council's first Commercial Strategy, which aims to support future financial sustainability by:
  - maximising income generation;
  - taking a commercial approach to assets (through its asset investment policy); and
  - creating a commercial culture within the Council.
- the Strategy provides a framework for commercial activity against which both new and existing commercial activity is evaluated. To support this approach, and help monitor and manage the associated risks, the Council has created a commercial team from existing staff with relevant skills and experience, supported by external expertise when required. The Strategy is supported by an action plan and a range of performance indicators and key deliverables.
- an Asset Investment Policy provides additional guidelines in relation to commercial asset acquisition or investment. The Policy was approved by the

[12] Castlegate Business Park was acquired in September 2018 and Newport Leisure Park in March 2019, therefore only part-year income received in 2018-19.

Council in May 2018, along with a £50m borowing facility to fund asset investments. The Policy initially covered only land and building acquisitions, but in February 2019, the Council agreed to widen the Policy's definition of a commercial investment to enable consideration of:

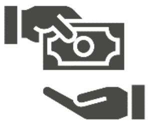
– commercial loan facilities;
– building or renovating investment portfolio holdings; and
– equity or debenture interest, eg in a business sector start up company.

Exhibit 9: Council borrowing

The exhibit below shows the total amount of money that the Council has borrowed to fund commercial investments, as well as the cost of all the borrowing that the Council has as a proportion of its net revenue budget.

£30.7m

Amount of borrowing to fund commercial investments[13]



5.0%

Cost of total borrowing as a proportion of net revenue budget 2018-19[14]

[13] Source: Council's self-assessment

[14] Source: Monmouthshire County Council's Statement of Accounts 2018-19

Wales Audit Office
24 Cathedral Road
Cardiff CF11 9LJ

Tel: 029 2032 0500
Fax: 029 2032 0600
Textphone.: 029 2032 0660

E-mail: info@audit.wales
Website: www.audit.wales

Swyddfa Archwilio Cymru
24 Heol y Gadeirlan
Caerdydd CF11 9LJ

Ffôn: 029 2032 0500
Ffacs: 029 2032 0600
Ffôn testun: 029 2032 0660

E-bost: post@archwilio.cymru
Gwefan: www.archwilio.cymru