

Financial Sustainability Assessment – Powys County Council

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Mae'r ddogfen hon hefyd ar gael yn Gymraeg. This document is also available in Welsh.

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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 between February 2021 and April 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

Addressing the medium-term budget gap

- P1 The Council needs to formulate and progress its plans to meet the medium-term budget gap, including:
- assessing the medium to long-term impact and opportunities arising from the pandemic and any resultant changes proposed to its service delivery model;
 - ensuring that its budget strategy considers, and is consistent with, other plans it has formulated eg workforce strategy, use of digital services; and
 - continuing to strengthen its savings planning process and evaluate why savings are not achieved, to inform future plans.

Capital Strategy

- P2 The Council needs to ensure that its ambitious capital programme is affordable. This will require additional detail and improvements being made to its Capital Strategy with regard to:
- the forecast level and timing of capital receipts; and
 - the impact that any additional financing requirements will have on its revenue budget.

Budget Planning Processes

- P3 Due to the extraordinary nature of the 2020-21 financial year, it is difficult to determine the extent to which the improvements made to the Council's budget planning processes contributed to the improved forecast year-end position. It is important therefore that the Council continues to ensure that it monitors whether its budget planning processes are having the desired effect and helping to prevent significant overspends in key service areas.

The Council has a significant medium-term budget gap and despite improvements to aspects of its financial management arrangements in recent years, it still faces a number of key risks which could impact on its financial resilience going forward

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.

7 We found that:

- the Welsh Government's commitment to maintain financial support for councils for the first six months of 2021-22 provides the Council with a level of confidence about its short-term financial position. However, risks remain in relation to the level of any ongoing additional COVID-19-related expenditure or lost income if the impact of the pandemic continues to be significant during the latter half of the financial year.
- the Council is taking a relatively prudent approach to its financial planning arrangements and is assuming that the levels of Welsh Government and UK government funding will not continue at the same level as they have been over the past 12 months. Departments and services are being reminded that additional funding is unlikely to be available on an ongoing basis.
- as shown in **Exhibit 2**, the Council's additional COVID-19-related expenditure and income losses are significant, but the majority of these have been covered by UK and Welsh Government funding. The pandemic, has not, therefore, had a detrimental impact on the Council's short-term financial position to the extent that it was initially forecasting at the end of Quarter 1 of the 2020-21 financial year.
- given the ongoing nature of the pandemic and the uncertainty attached to this, the Council is yet to assess the potential impact on its future operating model and service delivery provision in its Medium Term Financial Strategy (MTFS). This is a key matter that the Council will need to undertake detailed work on in the coming months.

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

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.

Figures below relate to the Welsh Government Hardship Fund and do not include any additional COVID-related Grant Funding.

The additional amount the Council estimates it will have spent, as a result of COVID-19 over 2020-21.	£14.221 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£3.941 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.	£17.039 million
The cost to the Council of COVID-19 over 2020-21, after extra funding from the Welsh Government is taken into account.	£1.122 million

Source: Powys County Council

The Council continues to have a significant medium-term financial budget gap, and the impact of the pandemic has delayed its ability to consider the key actions it needs to take to address this

Why strategic financial planning is important

8 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.

We found that:

- our 2019-20 financial sustainability report highlighted that the Council had faced considerable challenges over recent years which meant that its

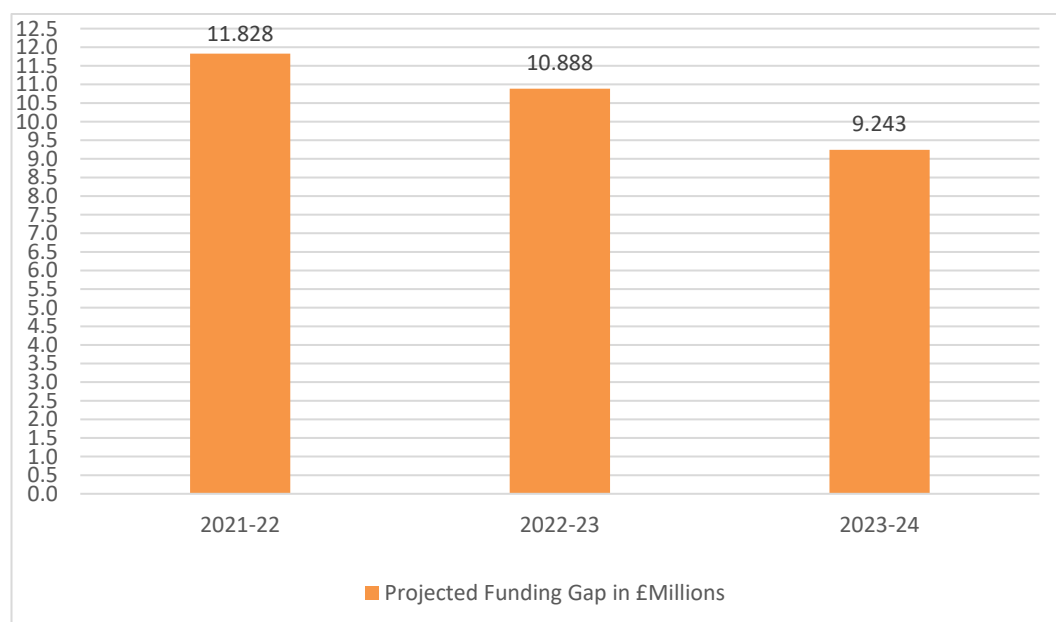
financial performance has not been sustainable. However, the Council understood the significant financial challenges it faced over the medium-term and was working to strengthen its overall financial resilience.

- our 2019-20 report also outlined that the MTFS for 2020 to 2025 identified significant funding gaps for future years, and that the recently introduced integrated business planning process together with its transformation programme were key to the Council meeting those gaps.
- the Council has confirmed, however, that the impact of the pandemic has delayed its ability to consider the key actions it needs to take within services, and that further work is therefore required to address the longer-term projected funding gaps within its MTFS and Integrated Business Plans.
- in setting its 2021-22 budget, the Council has updated its MTFS for the period 2021-2026. The MTFS highlights that the Council continues to face significant financial challenges going forward and, on a worse-case scenario, estimates a budget gap of £37.346 million during the period April 2022 to March 2026.
- in addition to this, planned savings of £19.548 million have already been identified for the period 2021-22 to 2025-26, giving an overall budget gap of £56.894 million over the five-year period.
- the updated MTFS worst-case scenario basis includes some fairly prudent assumptions. These include that the level of Revenue Support Grant Funding (RSG) will reduce by approximately 2% until 2025-26. The Council plans on the basis of a range of scenarios including flat cash settlement and +2%. Most other authorities assume no increase or a decrease to current funding levels.
- the updated MTFS also sets out risks including change delivery capacity, delivery of cost reductions, treasury management and availability of reserves which could impact on its overall financial strategy in the longer term.
- other risks are identified by the Council, but not contained within the MTFS, include the funding of its ambitious capital programme, particularly around schools' transformation.
- the level of its Capital programme as outlined in its Capital Strategy is significant (ie £628 million over the next ten years). This includes £380 million of non-HRA and £248 million of HRA expenditure. Approximately 70% of this expenditure (£439 million) is planned to take place within the next five years to 2024-25.
- the most significant element of the non-HRA Capital expenditure relates to the Council schools' modernisation and major improvements programme which is forecast to cost approximately £136 million between 2021-22 to 2023-24.
- the Capital Strategy also outlines that the net financing need for the period to 2024-25 is £205 million. The Council recognises, however, that further work is required in terms of its Capital Strategy particularly with regard to how it is

to fund the capital programme going forward. This includes, for example, more detail on the anticipated level of Capital Receipts and the impact that any additional financing requirements will have on its revenue budget.

Exhibit 3: the Council has a total projected funding gap for the three years 2021-22 to 2023-24 of £31.959 million

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



Source: Powys County Council updated Medium Term Financial Strategy, updated February 2021

With the exception of the 2020-21 financial year, the Council’s useable reserves have declined in recent years, and they are relatively low in relation to the net cost of services compared with other Welsh councils

Why sustainable management of reserves is important

- 9 Healthy levels of useable 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 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.

10 We found that:

- our 2019-20 report highlighted that although the level of the Council's general fund has remained fairly constant since March 2017, its level of earmarked reserves had declined. Earmarked reserves have fallen from £28.3 million in March 2017 to £19.1 million in March 2020, a decrease of £9.2 million. The general fund has been maintained and remains in line with the Council's reserve policy.
- the Council has previously agreed the principle that reserves will not be used to fund recurrent deficits and this principle continues to be applied going forward. The recent MTFS reiterates the need for prudent reserve levels to support ongoing financial challenges.
- previous audit work has highlighted that the Schools Delegated Reserves were also under pressure with a deficit reserve at 31 March 2020 of £1.26 million. The Revenue Outturn Report for the 2020-21 financial year presented to Cabinet on 22 June 2021 highlights that the position at 31 March 2021 had improved to a surplus position of £2.880 million. This improved position is due to the receipt of a £4 million grant received in March 2021 to support school core costs. Despite the total school reserves showing a surplus position of £2.880 million, secondary school reserves continue to be in deficit. The deficit has reduced by £1.354 million during the year and as at 31 March 2021 is £2.078 million.
- the Council's draft Financial Statements for the 2020-21 financial year highlight that its Council Fund and Useable Earmarked Reserves have increased significantly in 2020-21. As at 31 March 2021, its Council Fund Balance was £13.634 million (31 March 2020: £9.471 million) and Earmarked Reserves were £34.142 million (31 March 2020: £19.114 million).

11 The Council's 2020-21 Budget Outturn report acknowledges the improved financial position for the current year but stresses that it is important to recognise that this is not driven by recurring funding. The report highlights that the Council is setting aside funding to support one-off costs that will aid recovery and meet short-term additional demand. This ensures that the Council's general fund is maintained at an appropriate level and provides an opportunity for the Council to maximise the opportunity presented to improve financial resilience as it moves into further uncertainty and the continuing challenges ahead.

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	£286.5	£262.8	£281.5	£274.0	£276.8
Total Useable Reserves in £ millions ²	£37.0	£37.1	£26.8	£28.6	£47.8
Total Useable Reserves as a percentage of the net cost of services ³	13.6%	14.4%	8.1%	10.4%	17.2%
Comparison with the other councils of Wales	14/22	12/22	21/22	15/22	2020-21 comparison not available

Source: Audit Wales central team analysis

The Council's performance against budget for 2020-21 shows an improved position compared to previous years

Why accurately forecasting expenditure is important

- 12 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.
- 13 We found that:
- one of our key messages from the 2019-20 report was that the Council has consistently overspent in key service areas (eg Children's Services, Adult Services and Highways, Transport and Recycling) against its budget in recent years. Additional grants awarded late in the financial year, use of specific reserves and other accounting adjustments (eg the change in the Council's policy for its Minimum Revenue Provision) have helped to significantly reduce the forecast level of deficits or ensured that previously predicted overspends did not occur. The Council's Revenue Outturn forecast

² 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

³ Audit Wales calculation.

to the year-end as at 28 February 2021 indicated that three service areas would be overspent: Adult Services (£707,000), Children’s Services (£60,000) and Finance (£348,000).

- the financial forecast for 2020-21, as at 28 February 2021, also highlights that additional funding streams received late in the financial year have significantly impacted on previous in-year financial forecasts. The report highlighted that several Welsh Government funding announcements were made throughout February 2021, which provided additional grants totalling £7.8 million to support council services. Some of this funding is to be carried forward and will be utilised in 2021-22, whilst other elements are to be utilised to offset in-year expenditure. The additional support provided by the Welsh Government significantly altered the Council’s previously predicted deficit position at the year-end. The Council is now forecasting a projected surplus of £7.902 million (£5.906 million when HRA and Schools delegated budgets are excluded).
- the Council has aimed to address patterns and issues around the delivery of planned budgets in recent years through the introduction of its Integrated Business Planning (IBP) process, transformation programme and a changed approach to setting budgets within services. As highlighted above, the Revenue Outturn forecast indicates an overall improved performance against budget for most key services. However, due to the extra-ordinary nature of the financial year, where additional unplanned expenditure and lost income have occurred as a result of the COVID-19 pandemic, it is difficult to confirm whether the improvements in the budget planning process had the desired affect or whether the improved performance is as a result of additional funding being provided by the Welsh Government.

Exhibit 5: the following exhibit shows the amount of overspend or underspend for the Council’s overall net revenue budget for the last four years and also the year to date as reported forecast at the end of February 2021

	2016-17	2017-18	2018-19	2019-20	2020-21
Original Net revenue budget £ millions ⁴	£237.10m	£240.00m	£247.00m	£255.20m	£269.40m
Actual Net Revenue Outturn ⁵	£237.14m	£234.74m	£244.78m	£251.40m	£261.50m

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

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

	2016-17	2017-18	2018-19	2019-20	2020-21
Amount of overall surplus/overspend ⁶	-£0.04m overspend	£5.26m surplus	£2.22m surplus	£3.8m surplus	£7.9m surplus
Percentage difference from net revenue budget	-0.01%	2.19%	0.89%	1.49%	2.93%

Despite making incremental improvements to the rigour and challenge to savings proposals, the full quantum of annual savings required is not being achieved

Why the ability to identify and deliver savings plans is important

- 14 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.
- 15 We found that:
- a key message from our 2019-20 report was that the Council does not have a track record of delivering the totality of its planned annual savings targets. Despite making incremental improvements to the rigour and challenge to savings proposals made by service areas over recent years, the Council has not achieved more than 80% of its annual savings targets.
 - as at 28 February 2021, the Council was forecasting that it will achieve £9.544 million of its savings target of £12.394 million for the 2020-21 financial year. This represents approximately 77 % of its target. Of the £2.85 million of savings that are not predicted to be achieved, £1.634 million are now not considered to be deliverable, in the main due to the impact of the pandemic which halted transformation projects as the Council concentrated on business critical work. These have been reviewed and removed from the 2021-22 budget.
 - the remaining £1.216 million is still currently considered to be deliverable and has been rolled forward to 2021-22 and beyond.
 - if the Council achieves the same level of savings it predicts in 2020-21 (ie 77%) over the next five financial years, it will mean that it will only achieve £37.9 million of its target of £49.174 million.

⁶ Audit Wales calculation.

- therefore, the Council's ability to deliver the full quantum of savings as outlined in its MTFS over the next few years continues to represent a significant risk to its financial sustainability going forward.

Exhibit 6: savings delivered during 2019-20 as a percentage of planned savings

The following exhibit sets out how much money the Council intended to save from its savings plans during 2016-17 and 2019-20, and how much of this it actually saved as well as estimated figures for 2020-21.

	2016-17	2017-18	2018-19	2019-20	2020-21 estimate
Total planned savings in £ millions ⁷	12.1m	11.8m	12.3m	21.7m	12.4m
Planned savings achieved in £ millions ⁸	9.6m	8.3m	6.5m	15.9m	9.5m
Planned savings not achieved in £ millions	2.5m	3.5m	5.5m	5.8m	2.9m
Percentage of savings achieved	79%	71%	53%	73%	77%

Source: Powys County Council

The Council's financial liquidity ratio is fairly low, but shows a steady position over the last few years

Why the Council's liquidity position is important?

- 16 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.

⁷ 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

⁸ 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

- 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.

17 We found that:

- **Exhibit 7** provides an analysis of the Council's liquidity position since 2015-16. A liquidity ratio above 1.0 means that a council has more current assets at that point in time, than current liabilities.
- the analysis shows that since 2015-16, the Council's liquidity ratio has decreased to below 1.0. The key reason for this decrease is that there has been a significant increase in the level of short-term borrowing and short-term creditors over this period. Short-term borrowing has increased from £3.0 million in 2015-16 to £73.4 million in 2020-21, and short-term creditors have increased from £28.6 million to £49.0 million over the same period.
- during this period, the most significant movement in current assets relates to short-term debtors which have increased by £20 million.
- the Council's liquidity ratio based on its draft 2020-21 financial statements will remain at 0.8 at the end of the 2020-21 financial year.

Exhibit 7: working capital ratio 2015-16 to 2019-20 from the Statement of Accounts and Audit Wales calculation, and 2020-21 from Powys County Council

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 estimate
Current Assets ⁹	£38.1m	£59.0m	£38.5m	£50.9m	£60.4m	£107.8m
Current Liabilities ¹⁰	£33.7m	£66.4m	£52.4m	£57.7m	£74.7m	£136.7m
Liquidity Ratio	1.1	0.9	0.7	0.9	0.8	0.8

⁹ Current Assets, includes: Short Term Investments; Assets held for sale; Inventories; Short Term Debtors; and Cash and equivalent

¹⁰ Current Liabilities, includes Short Term Borrowing; Short Term Creditors; and Provisions due in one year.



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