

Financial Sustainability Assessment – Rhondda Cynon Taf County Borough Council

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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 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 February to June 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

Planning assumptions

- P1 The Council needs to be assured that it has contingency plans in place to be able to manage less positive scenarios than it planned for in its medium-term financial planning.

Medium term financial planning

- P2 Discussions are ongoing about the Council's estate, workforce and digital capabilities and these need to be formalised in the Council's financial planning arrangements.

Detailed report

The Council continues to be well placed to manage its financial sustainability

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

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.

6 We found that:

- the majority of the Council's additional expenditure and income losses as a result of COVID-19 have been covered by Welsh Government funding and so have not destabilised the Council's financial resilience.
- the Council's medium-term financial plan (MTFP), updated in October 2020, assumes that Welsh Government will continue to cover any Covid related expenditure or income losses.
- the Council has taken account of the impact of the pandemic in its budget strategy for 2021-22. For example, it has factored in additional costs in its waste management and public protection services, increased its local NDR scheme and frozen some of its fees and charges. However, it remains reliant on Welsh Government Hardship fund continuing. The Council is very aware that the area has been significantly impacted by the pandemic and that it needs to consider the medium to long term implications in its strategic planning. We expect this to be reflected in its updated MTFP in July 2021.
- as a result of additional Welsh Government funding, the Council has taken the opportunity to make further investments of about £6 million into its capital programme in line with its corporate priorities.

Exhibit 2: Council's figures on the cost 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.

The additional amount the Council estimates it will have spent as a result of COVID-19 over 2020-21.	£37 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£14 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.	£51 million
The cost to the Council of COVID-19 over 2020-21 after extra funding from the Welsh Government is taken into account.	£2.041 million

The Council's financial planning has served it well to date, which it can build upon to consider how it manages its budget gap over the medium term

Why strategic financial planning is important

- 7 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:

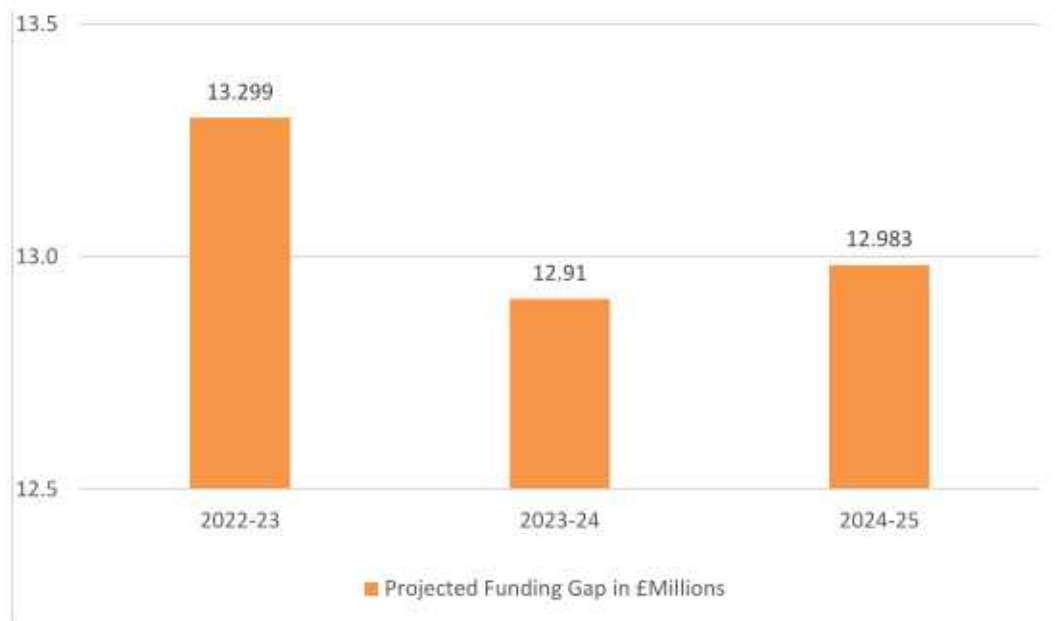
- the Council's approach to its financial planning has served it well to date. It identifies savings early and incorporates these into its base budgets. It has built up a healthy level of reserves.
- the Council reviews its medium-term financial plan (MTFP) annually. An update to the MTFP covering the period 2021-22 to 2024-25 was considered by Cabinet in July 2021. The updated MTFP is due to be considered by Council in September.
- as shown in **Exhibit 3**, the MTFP update in July 2021 identifies that the Council has a total projected funding gap for the three years 2022-23 to

2024-25 of £39.191 million (based on a 3% settlement and 2.65% annual Council Tax increase).

- for 2021-22, the Council has identified efficiencies of £4.6 million, which it has removed from the base budget requirements. After a series of investments agreed as part of the budget for 2021-22, the Council has identified a remaining gap of about £711,000. It intends to use its transition funding to address this gap.
- the Council identifies risks and key demand pressures and reflects its corporate priorities and the sustainability of its services in its financial planning. The Council has identified investment priorities against each of its strategic objectives. Discussions are ongoing about the Council's estate, workforce and digital strategies and we would expect to see these formalised in its financial planning arrangements.
- the Council has set out at a high level how it intends to meet its budget gap over the next three years. This includes its social services transformation programme, continued delivery of efficiency savings, as well as maximising opportunities in areas such as digital and commercialisation.
- whilst the Council has not set out in detail how it will meet the budget gap over the term of the MTFP, it is in a healthy financial position and has a number of options available to it to help it address the gap. The Council has a track record of addressing its previous budget gaps. Consequently, the Council is confident it will be able to manage its budget gap over the medium term. Currently, we do not have any concerns about the Council's financial sustainability.
- the updated MTFP models the budget gap for 2022-23 to 2024-25 against three different revenue support grant scenarios: +2%, +3% and +4%. The updated MTFP also identifies the budget gap if there should be a cash flat (0%) revenue support grant. The Council has modelled its budget gap assuming a 2.65% annual Council Tax increase.
- the Council's final 2021-22 settlement saw an increase of 3.8%, within the range of scenarios it had modelled. Its budget is based on a local government pay freeze with about £1 million provision for increased pay awards for staff on salaries below £24,000. The Council has taken the opportunity to set up an earmarked reserve for pay awards and will need to factor this into its medium-term financial planning.
- historically, the Council's assumptions to date have been realistic. The final settlement for 2021-22 was within the range of assumptions the Council had planned for. We appreciate the levels of uncertainty around assumptions, a 1% difference in the settlement equates to about £3.9 million for the Council. The Council's financial situation is such that it is confident it can cope with fluctuations in settlements in the short-term, but the Council needs to be assured that it has contingency plans in place to be able to manage less positive scenarios than it planned for in its medium-term financial planning.

Exhibit 3: the Council has a total projected funding gap for the three years 2022-23 to 2024-25 of £39.191 million

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



Source: Medium term financial plan update Cabinet July 2021 (based on a 3% settlement and 2.65% annual Council Tax increase)

The Council has a healthy level of reserves and it uses them to support its financial sustainability

Why sustainable management of reserves is important

- 8 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.

We found that:

- in our 2019-20 financial sustainability report, we found that the Council had a reasonable level of useable reserves.
- our more recent review has found that the Council's total useable reserves have increased from £138.9 million in 2016-17 to £171.3 million as at the end of March 2021.
- in February 2020, the Council used £1.5 million from its general fund balance reserves to help it manage the costs of the impact of Storm Dennis. Using its reserves this way demonstrates the Council's willingness and ability to use its reserves to fund unforeseen pressures. This meant that the level of its general fund balances reserves was lower than the £10 million level recommended by the Council's Section 151 Officer. However, the Council has plans in place to replenish this reserve over the course of the next three years.
- the Council has a Medium-Term Financial Planning and Service Transformation Reserve, which it uses as transition funding to support its overall budget strategy. It has increased this reserve during 2020-21 and plans to use £0.711 million from this reserve to help it meet the funding gap in 2021-22, reducing this reserve to about £3.6 million. Again, it is confident that by reviewing its base budget requirement and achieving efficiencies early, it will be able to replenish this reserve during the course of the MTFP.

Exhibit 4: amount of reserves vs 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 ²	472.1	477.1	491.5	505.6	505.8
Total Useable Reserves in £ millions ³	138.9	143.5	119.5	119.9	171.3
Total Useable Reserves as a % of net cost of services ⁴	29.4%	30.1%	24.3%	23.7%	33.9%
Comparison with the other councils of Wales	3/22	3/22	6/22	6/22	[2020-21 comparison not yet available]

Sources: statement of accounts

Exhibit 5: total usable reserves as a percentage of net cost of services



Source: Audit Wales analysis

² 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.

³ 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.

⁴ Audit Wales calculation.

The Council has a track record of delivering its services within its overall revenue budget

Why accurately forecasting expenditure is important

- 9 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.

We found that:

- the Council continues to have a good track record of financial management and generally delivers its services within agreed budgets.
- the Council's draft outturn position for 2020-21 forecasts an overspend of £0.204 million against its revenue budget. This is after the Council has transferred funds to reserves. The Council has delivered a revenue surplus of about £52.2 million, which it has transferred into its useable revenue reserves. Like other councils, it received significant additional funding from Welsh Government at the end of the financial year. The Council has subsequently increased its level of useable reserves by over £60 million in 2020-21. This includes both capital and revenue.
- there are overspends in some key services: £2.464 million in its safeguarding and support services for children and about £1.3 million overspend in adult services. There is also a £0.602 million overspend in waste services. The Council understands the causes of these overspends and highlights the ongoing budget pressures in adults and children services in its quarter 4 budget report and updated MTFP in July. The Council's corporate risk register sets out mitigating actions for managing its adult and social services.

Exhibit 6: 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 four years and the year to date as at end of December 2020.

	2016-17	2017-18	2018-19	2019-20	2020-21
Original Net revenue budget £ millions	454.8	458.9	471.6	483.5	508.7
Reported Revenue Outturn	454.6	458.9	471.8	483.8	509.0
Transfers (to)/from reserves	(5.9)	(0.8)	24.7	(0.5)	(52.2)
Amount of overall (surplus)/overspend	(-6.1)	(0.8)	24.9	(0.2)	(52.0)
Percentage difference from net revenue budget	-1.3%	-0.2%	5.3%	-0.0%	-10.2

Source: statement of accounts for 2016-17 – 2019-20 and draft outturn report for 2020-21

The Council identifies and achieves savings early and builds these into its base budget requirements

Why the ability to identify and deliver savings plans is important

- 10 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.

We found that:

- the Council has continued to identify savings early and to only incorporate these into its base budget requirements when they have been secured. This approach has been effective to date and the Council has been able to achieve significant levels of savings and to maintain a healthy level of reserves.
- the Council's 2021-22 budget strategy states that the Council has identified £4.6 million of efficiencies which it has taken out of the base budget requirement for 2021-22.
- since 2017-18, the Council has identified about £42 million efficiencies, which it has taken out of base budget requirements.
- in this budget report, the Council's Section 151 officer highlighted the challenge of continuing to deliver significant efficiencies without impacting

front-line services. However, it is evident that the Council's priority remains to protect its front-line services and that it will continue to explore alternative efficiencies.

The Council's liquidity position is less than 1 but the Council does not consider this to be a significant risk as its borrowing is within its capital financing requirement levels

Why the Council's liquidity position is important

- 11 Why gauging current assets to current liabilities (liquidity) is important:
- 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.

We found that:

- at the end of 2019-20, the Council had a liquidity ratio of 0.8, which has declined from 0.9 in 2015-16. The Council's liquidity ratio for 2020-21 is a slightly improved position, but the trend analysis in **Exhibit 7** below shows that the ratio has always been less than 1.
- a liquidity ratio of below 1 means that the value of its current assets is less than its current liabilities.
- the Council do not consider its liquidity ratio to be a significant risk, which is consistent with its Treasury Management strategy, and it has not experienced any liquidity issues. Its borrowing is below its capital financing requirement level and within its prudential borrowing limits.

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

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Current Assets ⁵	90.3m	73.0m	79.7m	107.7m	130.4m	164.4m
Current Liabilities ⁶	104.9m	139.5m	174m	193.5m	171m	167.7m
Working Capital Ratio	0.9	0.5	0.5	0.6	0.8	0.98

Sources: Statement of Accounts and draft outturn July report for 2020-21

⁵ Current Assets includes: Short Term Investments; Assets held for sale; Inventories; Short Term Debtors; and Cash and equivalent.

⁶ Current Liabilities, includes Short Term Borrowing; Short Term Creditors; and Provisions due in one year.



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