

# Financial Sustainability Assessment – Merthyr Tydfil County Borough Council

Audit year: 2020-21

Month/Year issued: August 2021

Document reference: 2542A2021-22

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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**<sup>1</sup>. 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 January 2021 and March 2021.

<sup>1</sup> 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	The Council should include cash flat or minus settlement figures, in addition to other more positive scenarios it may wish to use, when it projects its future funding gaps.
P2	The Council must build on its current financial position to strengthen its financial resilience. It is imperative that it takes a much more medium to long-term approach to its planning including considering the level of savings it expects to realistically achieve through transformation, and the level of investment needed to deliver the RTI Plan beyond 2021-22.

The Council's immediate financial position has improved but it needs to consider how it can best use its resources to strengthen its financial sustainability over the medium term

### 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:

- as **Exhibit 1** below sets out, all of the Council's additional COVID-related expenditure and income losses have been covered by Welsh Government funding apart from £298,000 comprising equipment for home working. As well as compensating for loss of income and additional expenditure, the Welsh Government provided additional funding for specific COVID-related spending.
- the Council has assumed that in 2021-22, the Welsh Government Hardship Fund will cover homelessness costs of £871,000, school transport costs of £31,000, loss of car parking income of £275,000, and loss of conference income of £100,000. For subsequent years of the Medium Term Financial Plan (MTFP), the Council has factored in the £871,000 for homelessness and reductions in parking income into the additional demands section of the MTFP.
- in March 2021, the Council received £449,000 from the Welsh Government in respect of a contribution towards loss of Council Tax income collected. This money will be set aside within an earmarked reserve. The Council has increased its Council Tax Reduction Scheme recognising the potential impact of the pandemic.

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

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.	£7.104 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£2.004 million (includes £449,000 for loss of council tax income)
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.	£9.922 million
The cost to the Council of COVID-19 over 2020-21 after extra funding from the Welsh Government is taken into account.	£298,000 was not directly reimbursed but the Council received additional monies in excess of this amount

## The Council needs to take a much more medium to long-term approach to its financial planning, including determining the level of savings it can realistically achieve through transformation, and the investment required to deliver the Recovery, Transformation and Improvement Plan

### Why strategic financial planning is important

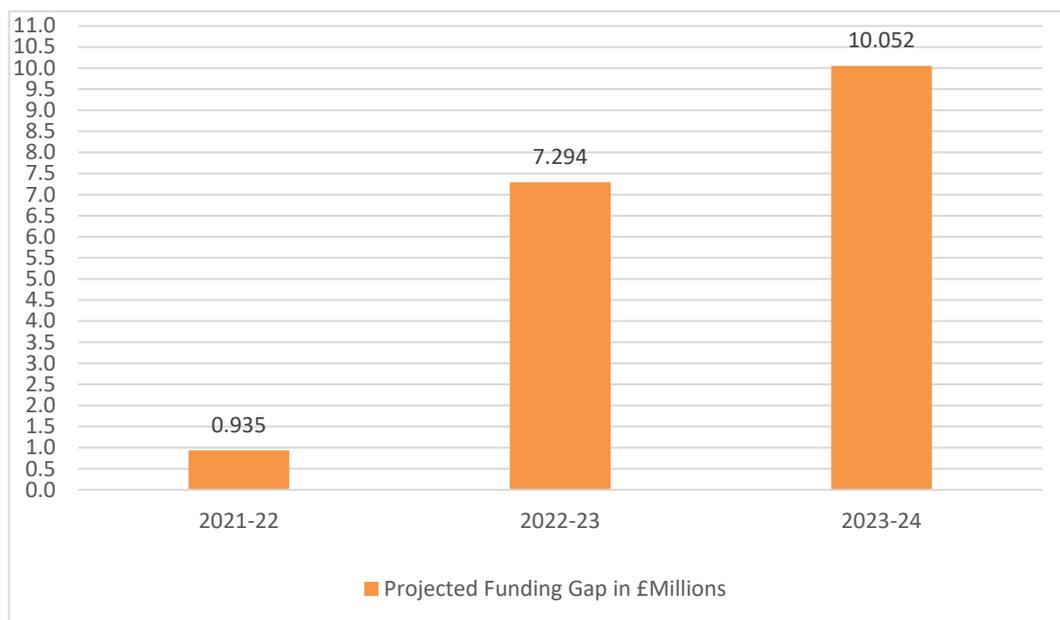
- 8 A clear and robust financial strategy is important to identify the likely level of funding available to a council, as well as the anticipated level of demand for, and cost of, providing services. Given the recent and anticipated funding pressures facing all councils, it is also important to identify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

9 We found that:

- in March 2021, the Council revised its MTFP to cover the period from 2021-22 to 2024-25.
- the MTFP sets out three different scenarios in respect of the funding gap up to 2024-25. The most cautious scenario is based on a 2% revenue settlement increase from the Welsh Government for 2022-23, 2023-24 and 2024-25. This scenario leaves the Council with an overall funding gap of £13.740 million in total for the period up to 2024-25. However, there is no guarantee that a 2% settlement increase will be given for each of these three financial years, so in reality the funding gap could be even larger. The Council will need to ensure that it has contingency plans should future settlements be less positive and should incorporate cash flat or minus settlement scenarios in future MTFPs.
- for 2021-22, the Council has identified service efficiencies of £935,000 and the Council has taken this amount out of its base budget requirements for 2021-22.
- to date, the Council's focus has been on annual budgets rather than planned long-term efficiencies or transformational savings. The Council is in the process of identifying the savings it intends to achieve through its Recovery, Transformation and Improvement (RTI) Plan, as well as any investments required to deliver on it. A report on financing the RTI Plan was taken to the full Council meeting on 14 July 2021. That report sets out that the £802,000 investment requirement for 2021-22 will be financed from the revenue outturn from 2020-21. The intention is that subsequent years will be financed from additional demands included within the MTFP, but there is no guarantee that those monies will be available.
- the Council received a 4.8% increase in its revenue support grant for the 2020-21 financial year and a 4.6% increase for the 2021-22 financial year. Because of these relatively favourable settlements, the Council's short-term financial position has improved, and it now needs to use this window of opportunity to plan for the medium to long term.
- the Council has recognised that it had urgent capacity issues and has taken steps to address some of them, with £705,000 included in the 2021-22 revenue budget. However, it is likely that further investment will be needed in future years that will need to be factored into the MTFP.

**Exhibit 3: the Council has a total projected cumulative funding gap for the three years 2021-22 to 2023-24 of £10.052 million**

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



Note: The projected funding gap is based on an assumption of a 2% settlement increase from the Welsh Government for 2022-23 and 2023-24. The £0.935 million is the service efficiencies to be made for 2021-22.

Source: Report to Cabinet, 3 March 2021, Budget 2021-22, Council Tax 2021-22 and Medium Term Financial Plan 2021-22 to 2024-25

**The Council’s general fund reserve has increased and is planned to be maintained in line with its reserves policy, however, there was an overall trend of decreasing useable reserves, but they have increased significantly in 2020-21**

**Why sustainable management of reserves is important**

- 10 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.

11 We found that:

- the Council's overall levels of useable reserves declined from £22.2 million in 2016-17 to £15.9 million in 2019-20, but the 2020-21 provisional outturn reports a significant increase to £25.7 million. The Council received significant additional funding from the Welsh Government at the end of the 2020-21 financial year.
- in 2020-21, the Council added £635,000 to its general reserves fund so this now amounts to £5.335 million, which is in line with its Corporate Reserves Policy. The Council currently has no plans to use any general reserves in the next two financial years.
- the Council plans to use £6.508 million of its earmarked reserves in the period up to 31 March 2023 for specific, planned purposes, funding the RTI Plan, digital transformation, COVID recovery, and the apprenticeships programme.
- the schools balances reserves position has increased to £4.267 million at 31 March 2021.

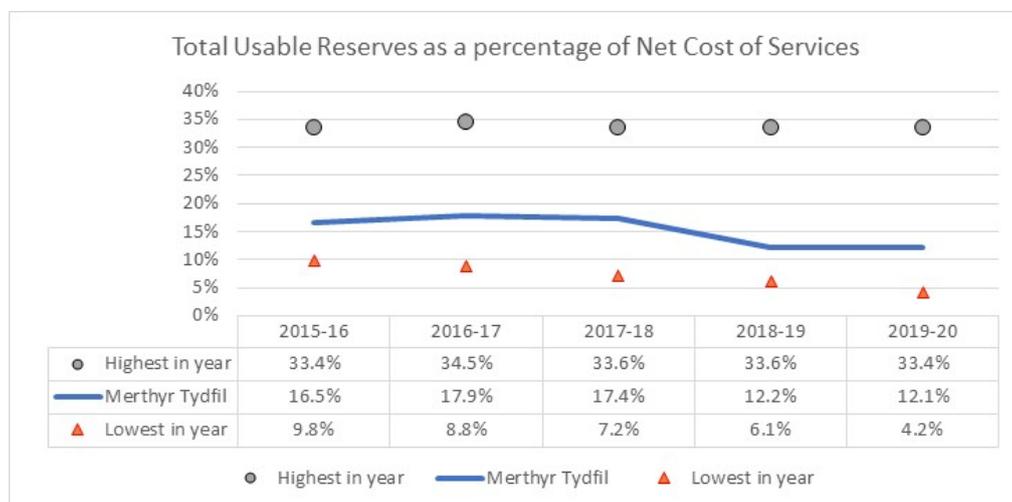
#### Exhibit 4: amount of reserves versus annual budget

This exhibit shows the amount of useable 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 <sup>2</sup>
Net Cost of Services in £ millions <sup>3</sup>	108.6	111.0	118.7	118.4	113.8
Total Useable Reserves in £ millions <sup>4</sup>	22.2	21.9	16.7	15.9	25.7
Total Useable Reserves as a percentage of net cost of services <sup>5</sup>	20.4	19.8	14.1	13.4	22.6
Comparison with the other councils of Wales	9/22	9/22	13/22	13/22	[2020-21 not yet available]

Source: Statement of Accounts

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



Source: Audit Wales analysis

<sup>2</sup> Unaudited figures.

<sup>3</sup> Value used is the net cost of services charged to the general fund from the Expenditure Funding Analysis, plus precepts, levies and debt interest. Source: Statement of Accounts

<sup>4</sup> By useable reserves, we mean the total general fund balance, together with earmarked reserves. Source: Statement of Accounts

<sup>5</sup> Audit Wales calculation.

## The Council has improved on its previous mixed record of performing against budget, with surpluses achieved in the last two financial 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.

### What we found

- 13 Our 2019-20 Financial Sustainability report found that the Council's performance against budget had fluctuated in recent years, and it used a significant amount of reserves to finance the shortfall. The use of reserves was mainly planned.
- 14 Recently, the Council's performance against budget has significantly improved. In 2019-20, there was an underspend of £2.9 million. The budgeted contributions of £483,000 from general reserves and £1.295 million budget reserve were retained within reserve balances, and £1.113 million was transferred to the budget reserve.
- 15 For 2020-21, the Council has a provisional surplus of £4.464 million, which includes circa £1.4 million of the additional Welsh Government funding received in March 2021.
- 16 The Council's recent improved performance against budget has been aided by the favourable settlements from the Welsh Government in 2019-20 and 2020-21, a redistribution of Joint Committee reserves and change in the Minimum Revenue Policy in 2019-20, and the significant COVID-19-related funding received from the Welsh Government during 2020-21.
- 17 Our May 2019 letter raised concerns about the £1.3 million overspend of its social care budget in 2018-19 and the unprecedented demand around looked-after-children. In 2019-20, the looked-after-children budget had a net budget deficit of £669,000, although there was an overall social services budget surplus of £376,000. As it stands, although the Council's looked-after-children budget has a provisional overspend of £669,000, the Council considers that the overall social care budget is under control with a provisional overall underspend of £2.24 million for social services, due to lower than anticipated costs for the provision of independent external care. The Council has taken some steps to mitigate the overspend within its looked-after-children budget and it is progressing aspects of the RTI Plan aimed at safely reducing children-looked-after numbers and improving outcomes for children looked after. The Council is very aware, however, that the budget position remains challenging, and it is planning for additional pressures in

the service over the next year. The Council's revenue budget for 2021-22 includes £591,000 for additional demand pressures for looked-after-children residential placement 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 five years.

	2016-17	2017-18	2018-19	2019-20	2020-21 <sup>6</sup>
Original Net revenue budget £ millions	114.2	114.8	117.5	120.3	127.5
Actual Net Revenue Outturn	112.6	113.5	118.1	119.2	123.1
Amount of overall surplus/overspend	1.6	1.3	-0.6	1.1	4.4
Percentage difference from net revenue budget	1.4	1.1	-0.5	0.9	3.5

Source: Statement of Accounts

### **The Council has a good track record of meeting savings targets, but those savings are insufficient to meet future funding gaps**

#### **Why the ability to identify and deliver savings plans is important**

- 18 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.

<sup>6</sup> Unaudited figures.

## What we found

- 19 Our 2019-20 Financial Sustainability report found that while the Council has a good track record of delivering savings, the magnitude of its financial deficits makes it difficult to achieve a sustainable financial balance.
- 20 **Exhibit 6** below sets out the percentage of planned savings achieved for each financial year since 2016-17.
- 21 Despite the positive track record, and the savings achieved to date, the Council still has a large funding gap going forward. The Council has identified £935,000 of service efficiencies that it is aiming to achieve in 2021-22, but beyond that, the scale of further savings that will need to be achieved over the term of the MTFP has not yet been identified.

### Exhibit 7: savings delivered as a percentage of planned savings

The following exhibit sets how much money the Council intended to save from its savings plans between 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	2.646	2.898	2.786	2.528	2.059
Planned savings achieved in £ millions	2.580	2.574	2.687	2.372	1.975
Planned savings not achieved in £ millions	0.066	0.324	0.099	0.156	0.084
Percentage of savings achieved	97.5	88.8	96.4	93.8	95.9

Sources: various MTCBC Change Programme reports

## The Council has a relatively weak liquidity position when compared to other councils, but the Council does not consider this to be a significant risk

### Why the Council's liquidity position is important

- 22 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.

23 We found that:

- at the end of 2019-20, the Council had a liquidity ratio of 0.6 which has declined from 0.8 in 2015-16.
- for the period between 2015-16 and 2019-20, the Council's liquidity ratio was one of the lowest when compared to other local authorities across Wales.
- the projected liquidity ratio for 2020-21 has increased to 0.9.
- the Council does not consider its liquidity ratio to be a significant risk, because it is borrowing in the short-term to finance capital expenditure rather than over the long term. This has been the Council's strategy for several years in order to take advantage of lower interest rates and was undertaken following discussions with the Council's Treasury Management consultants. This strategy is reviewed frequently (at least once a year) and when the time is right the Council will replace the short-term borrowing with longer-term borrowing.

#### Exhibit 8: working capital ratio 2015-16 to 2020-21

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 <sup>7</sup>
Current Assets <sup>8</sup>	27.3	25.2	34.7	35	41.6	70.7
Current Liabilities <sup>9</sup>	33.3	35.8	52.2	61.2	74.0	83.1
Working Capital Ratio	0.8	0.7	0.7	0.6	0.6	0.9

Source: Statement of Accounts

<sup>7</sup> Unaudited figures.

<sup>8</sup> Current Assets includes: Short Term Investments; Assets held for sale; Inventories; Short Term Debtors; and Cash and equivalent. Source: Statement of Accounts

<sup>9</sup> Current Liabilities includes: Short Term Borrowing; Short Term Creditors; and Provisions due in one year. Source: Statement of Accounts



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