Financial Sustainability Assessment – Pembrokeshire County Council

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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 between January 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	The Council should align its Corporate Plan and Medium Term Financial Plan to ensure that the Council's objectives can be suitably resourced.
P2	The Council should strengthen its arrangements to ensure the delivery of the planned savings set out in the Council's Medium Term Financial Plan.

The Council has managed its resources to deal with financial pressures to date but continues to face significant challenges to meet its anticipated funding gap going forward

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

7 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.

8 We found that

- despite the significant challenges the Council has faced due to COVID-19, its short-term financial position has not been significantly affected, although it has adversely impacted the achievement of planned efficiency targets. However, the longer-term effect on service provision and on financial management is largely unknown.
- the majority of additional expenditure/loss of income due to the pandemic has been funded by contributions from the Welsh Government.
- funding from the Welsh Government to compensate for the expenditure and loss of income is expected to be £20.4 million compared to expenditure of £21.1 million, leaving a shortfall of £700,000 which has been funded from existing resources. (See **Exhibit 2**.)
- other sources of funding in 2020-21 have included £1.2 million from HMRC to fund furlough costs, track and trace funding and additional general grant funding.
- the Council has established an earmarked reserve of £1.7 million for COVID-19 pressures but it is not expected to be used in 2020-21 and has been carried over to 2021-22. The approved revenue budget for 2021-22 does not include any additional provision for COVID-19 costs as the Council assumes the Welsh Government will continue to fund additional costs incurred.
- the Council's Medium Term Financial Plan (MTFP) 2021-22 to 2024-25 acknowledges there will be a longer-term impact of the COVID-19 pandemic on the Council's overall strategy, the way it provides services and its financial position. As yet these are largely unknown, and the full financial impact not assessed.

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 direct funding from the Welsh Government.

The additional amount the Council estimates it will have spent as a result of COVID-19 over 2020-21.	£13.8 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£7.3 million
The amount of additional funding the Council estimates it will receive from the Welsh Government Hardship Fund over 2020-21 to mitigate the impact of COVID-19.	£20.4 million
The cost to the Council of COVID-19 over 2020-21 after extra funding from the Welsh Government Hardship Fund is taken into account.	£0.7 million

Figures provided by Pembrokeshire County Council

The Council has a strategy to identify and address its financial challenges, but this is becoming more challenging to deliver year on year, with growing pressures on savings targets and continuing uncertainties over levels of funding

Why strategic financial planning is important

9 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.

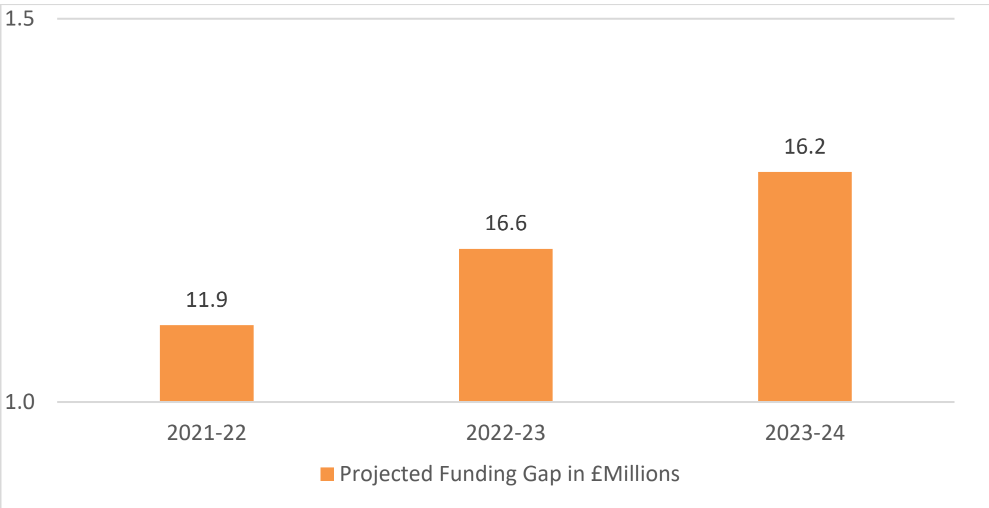
10 We found that

- previously, we concluded that the Council has a strategy to identify and address its financial challenges, but this strategy will potentially become more challenging to deliver year on year. This remains the case from 2020-21 onwards with growing pressures on savings targets and continuing uncertainties over levels of funding.

- the Council's approved MTFP sets out the key financial challenges and expected funding gaps and sets out the Council's assessment of how it intends to fund this gap over the next few years.
- the MTFP is based on the Council's key strategy and financial plans including the Corporate Plan, although this is not approved until after the MTFP is issued, so there is a risk of key objectives not being fully aligned.
- the Council has identified a projected funding gap of £44.7 million for 2021-22 to 2022-23 (see **Exhibit 3**). This is based on a number of assumptions including: the impact of re-pricing the base budget; estimates of future aggregate external finance funding (based on a 4% increase for 2021-22 but nil increase from 2022-23 onwards); council tax base changes; and the potential implications of Brexit. However, MTFP predictions exclude the potential future impact of the COVID-19 pandemic, as the Council assumes that further additional costs due to COVID-19 will be fully funded by the Welsh Government.
- the Council has developed plans to address the funding gap: the achievement of cost efficiencies is a key part of this. However, savings targets are becoming increasingly challenging due to previous slippage and budget pressures. There is also additional pressure on council tax income as the Council has not made its expected progress in moving to aligning council tax levels towards CTSS.

Exhibit 3: the Council has a total projected funding gap for the three years 2021-22 to 2023-24 of £44.7 million

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



Source – MTFP for 2021-22 to 2023-24

The Council's useable reserves have remained relatively stable in recent years but are expected to start decreasing from 2020-21 onwards and the Council has continued its record of not making unplanned use of reserves to fund revenue expenditure

Why sustainable management of reserves is important

11 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.

12 We found that:

- the Council's useable reserves have remained relatively stable in recent years but are expected to decrease from 2020-21 onwards and the Council has continued its record of not making unplanned use of reserves to fund revenue expenditure. (See **Exhibit 4**.)
- the Council had useable reserves of £45.7 million in 2019-20, equivalent to 18.9% of its net cost of services. This compares to the equivalent figures across the councils of Wales with 33.4% being the highest and 4.2% the lowest. (See **Exhibit 5**.)
- general reserve fund balances continue to be held at £7 million and have remained at this level since 2016-17, in line with the Council's 'Reserves Policy'.
- usable reserves are expected to decrease by £7 million (15%) to £38.7 million in 2020-21. Planned movements include a net £1.6 million contribution from the Asset and Repair Reserves, £3.5 million from the Transformation Reserves towards Programme for Administration costs and Individual Schools Reserves to reduce by £1.2 million.
- the MTFP projects further decreases in planned usable reserves of £1.6 million (4%) to £37.1 million in 2021-22.
- the Council has historically not relied on unplanned use of reserves to fund revenue expenditure. However, whilst not 'unplanned', the Council has approved a contribution of £2.6 million from earmarked reserves towards 'bid for growth' to bridge the funding gap identified in the MTFP for 2021-22.

Exhibit 4: amount of reserves versus annual budget

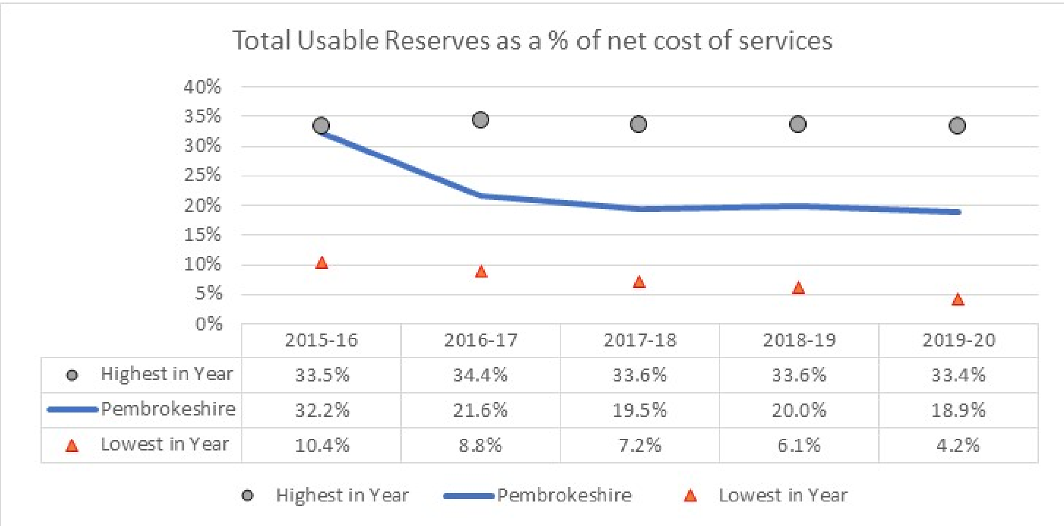
This exhibit shows the amount of usable reserves the Council had during 2019-20 and the previous three years as a proportion of the net cost of the services the Council delivers.

	2016-17	2017-18	2018-19	2019-20
Estimated Net Cost of Services in £ millions [2]	217.5	221.7	232.8	242.1
Total Useable Reserves in £ millions [3]	47	43.1	46.4	45.7
Total Useable Reserves as a percentage of net cost of services [4]	21.6%	19.5%	20.0%	18.9%

Source – Pembrokeshire County Council's Statements of Accounts 2016-17 to 2019-20

Exhibit 5: comparison with the other councils of Wales

The following graph shows a comparison of Pembrokeshire County Council's total usable reserves as a percentage of Net Cost of Services in comparison to the other councils of Wales.



Source – Audit Wales data comparison

[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 largely met its budget requirement in recent years reporting relatively small variances against its overall net revenue budget. However, there were significant overspends in some service areas

Why accurately forecasting expenditure is important

13 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.

14 We found that:

- in recent years the Council has largely met its budget requirement with relatively small variances reported against its overall net revenue budget. However, as reported previously there were significant overspends in some service areas.
- the Council has achieved this position by collecting more council tax than it has budgeted for, reduced capital financing costs due to one-off in-year adjustments, securing additional funding from the Welsh Government and the use of a contingency allocation in the annual budget in recent years of £1.2 million.
- the Council reported an overall underspend at the end of 2019-20 of £0.2 million with an expected underspend of £0.4 million at the end of 2020-21. (See **Exhibit 6**.)
- however, there have been continuing trends of departmental overspending in recent years. Social Care budgets in particular have reported overspends due to service pressures and increasing demands on the following areas:
  - Adult Care services overspent in 2019-20 by £2.3 million (5% of its net budget) and £2 million in 2020-21(3% of its net budget).
  - Children's Services reported overspends in 2019-20 of £0.2 million (2% of its net budget) but it is estimated this is to increase significantly to £1.9 million (14% of budget requirement) in 2020-21.
- the Council changed its budget strategy from 2020-21 onwards with all departments given a flat-rate nil increase and a requirement to fund service pressures from within this. For any additional funding identified, departments must submit 'growth bids' and these are only approved once the service has been through a business review.
- in November 2020, the Council's Cabinet approved the establishment of the 'Performance and Challenge Board' to provide additional challenge to the budget setting and monitoring process for 2021-22 onwards, including detailed service reviews and reviews of departmental 'bids for growth'.

- a contingency of £1.2 million was included in the 2020-21 budget for the purpose of dealing with unplanned budget pressures materialising in the year, including failure to deliver cost reductions/efficiencies and this is expected to be fully utilised. Due to the significant funding gap for 2021-22, the contingency was removed for the length of the MTFP from 2021-22 onwards with funding instead being allocated as part of departmental 'bids for growth'.

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 for 2020-21 as expected at 4 March 2021.

	2016-17	2017-18	2018-19	2019-20	2020-21
Original Net revenue budget £ millions	202.1	204.8	215.5	221.5	235.5
Actual Net Revenue Outturn	202.8	204.8	216.1	221.3	235.1
Amount of overall surplus/(overspend)	(0.7)	0.0	(0.6)	0.2	0.4
Percentage difference from net revenue budget	(0.4%)	0%	(0.25%)	0.09%	0.2%

Source – Budget Monitoring Reports to Cabinet 2016-17 to 2020-21

The Council has a variable record in delivering its planned savings but has seen slippage in the last two years creating additional pressures on future budgets. However, it is acting to address the ongoing risk of not achieving its cost efficiencies

Why the ability to identify and deliver savings plans is important

15 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

16 We found that

- the Council has a variable record in delivering its planned savings but has seen slippage in the last two years creating additional pressures on future budgets. The Council is acting to address the ongoing risk of not achieving its cost efficiencies.
- the Council's MTFP has built in an expectation that the Council will achieve at least 80% of planned savings each year. However, whilst the Council exceeded its targets in 2018-19 achieving 83.5%, savings for 2019-20 were not delivered as planned with only 66.2 % being achieved. (See **Exhibit 7**.)
- for 2020-21 only £3.8 million (47.5%) of the £8 million target is projected to be achieved. Whilst largely attributed to the impact of COVID-19 (particularly with delays in the Transformation Programme), this continues the trend of under-achievement from the previous year with slippage being carried forward to subsequent years adding to budget pressures.
- the resulting projected budget overspend has been offset by short-term measures including use of the £1.2 million contingency allocation, additional grant income and a one-off capital financing saving.
- the 'Transformation Programme' is currently being re-focused and along with external review of service provision and additional challenge being introduced into the budgetary process for 2021-22, the Council is taking steps to address the ongoing risk of not achieving its cost efficiencies.
- the MTFP has identified required cost efficiencies of £34.4 million (77%) as part of its plans to address the expected funding gap of £44.7 million for the period 2021-22 to 2023-24, including £4.2 million in efficiencies not achieved during 2020-21.

Exhibit 7: savings delivered during 2018-19, 2019-20 and estimated 2020-21 as a percentage of planned savings

The following exhibit sets how much money the Council intended to save from its savings plans during 2018-19 and 2019-20, and how much of this it actually saved as well as estimated figures for 2020-21.

	2018-19	2019-20	2020-21 estimate
Total planned savings in £ millions	11.6	15.7	8
Planned savings achieved in £ millions	9.7	10.4	3.8
Planned savings achieved percentage	83.6%	66.2%	47.5%

Source – Budget out-turn reports to Cabinet for 2018-19 to 2020-21

The Council has maintained favourable liquidity levels over recent years, supporting its financial position

Why the Council's liquidity position is important

17 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.

18 We found that:

- the Council has maintained favourable liquidity levels over recent years, supporting its financial position; and
- as an indicator of the Council's liquidity position, we reviewed working capital ratios and found that these have remained relatively stable over the five-year period to 31 March 2020 ranging between 1.9 and 3 and averaging at 2.2 per annum. (See **Exhibit 8**.)

Exhibit 8: working capital ratio 2015-16 to 2019-20

	2015-16	2016-17	2017-18	2018-19	2019-20
Current Assets in £ millions[5]	113.4	97.2	70.3	82.5	81.1
Current Liabilities in £ millions[6]	38.4	35.9	42.6	45.9	43.8
Working Capital Ratio	3.0	2.7	1.7	1.8	1.9

Source – Audited accounts 2015-16 to 2019-20 and estimates provided by Council 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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