

# Report

## Cabinet

---



### Part 1

Date: 11 November 2020

**Subject** Audit Wales Financial Sustainability Report

**Purpose** To present to Cabinet Audit Wales report on their 'Financial Sustainability Assessment on Newport City Council'

**Author** Head of Finance

**Ward** All

**Summary** As part of the programme of regulatory activity, and in accordance with the Well-being for Future Generations Act 2015, Audit Wales (AW) undertakes a programme of work to ensure the Council is discharging its duties under the Act. The report outlines AW findings from the review and concludes that: "The Council has a relatively strong financial position, but has recently recognised the need to develop a more strategic and sustainable approach to consolidate its position"

**Proposal** Cabinet are requested to note the outcome of the review, the Council's response and implementing the necessary actions raised.

**Action by** Cabinet

**Timetable** Immediate

This report was prepared after consultation with:

- Corporate Management Team

**Signed**

## Background

The Audit Wales (AW) is an independent public body that aims to ensure that the people of Wales know whether public money is being managed wisely and that public bodies in Wales understand how to improve outcomes. As part of the Council's regulatory activity, the AW undertakes a programme of work to ensure the Council is discharging its duties.

In 2019/20, AW undertook a review of 'Financial Sustainability Assessment on Newport City Council'. This was part of a national review and all Councils across Wales were assessed using a consistent framework.

The intention was then to produce a national report on the sector as a whole but due to the Covid-19 pandemic, this has been delayed given the potential and still uncertain impact on Council finances from this. A national report, taking into account the current position of Council finances and building on their 2019/20 review at individual Councils is due to be produced in the Autumn 2020.

In conclusion, AW found that "The Council has a relatively strong financial position, but has recently recognised the need to develop a more strategic and sustainable approach to consolidate its position"

### Summary of findings from Audit Wales report

Detailed findings of the report is attached at Appendix 1 (Welsh) and Appendix 2 (English).

The summary and some of the underlying main issues and observations are listed below for Members attention and information.

**The Council has a relatively strong financial position, but has recently recognised the need to develop a more strategic and sustainable approach to consolidate its position.** The AW reached this conclusion because of the following observations and evidence:

- (1) The Council does not yet have a sustainable strategy to support financial resilience and sustainability over the medium term:
  - We found that although the Council has a high-level medium-term financial projection that sets out its key financial challenges, its focus has primarily been on annual budgeting. The Council has recognised that it has not yet developed a strategic change programme to deliver a balanced and sustainable medium-term financial position.
  - The Council does not explicitly consider sustainable development in its medium-term projection and it does not have a medium-term approach to close its forecast deficit. The Council has not set out a strategic vision for the future direction of council services in light of the financial deficit. The Council recognises that further work is required to ensure the budget is balanced

Response/Actions: The Council recognises this and the newly appointed Chief Executive will work with Business Change/Finance colleagues to develop a more strategic approach with the Council's Strategic & Corporate Management Teams based on the development of strategies and medium term plans for key elements within service areas which will need to take into account the financial challenges forecasted. This is challenging due to the lack of certainty of future funding from Welsh Government.

The current Covid-19 pandemic and local elections in 2023 means this work will unavoidably delayed until 2021 realistically and will need to incorporate any new administration's strategic plans for the city from 2023.

- (2) While the Council has continued to underspend against its budget in recent years, its plans highlight that maintaining financial balance over the coming years will be more difficult;

- In recent years, overall the Council has underspent against its annual budget. However, within this overall underspend position, the financial outturn position has consistently reported continued overspends in a number of key service areas including social care and education
- Year on year the Council has seen significant overspends within service areas (excluding schools), in areas such as looked after children's out of county placements, adult community care, additional learning needs and independent fostering. These areas of budgetary pressure present an ongoing risk to the Council's financial position.
- The overall underspends in the table above have been supported by factors such as Council Tax surpluses, underspends against the Council Tax Reduction Scheme and revenue contingency budgets, and corporate services underspends, which have outweighed the pressures above. However, many of these underspends are uncertain in nature and there is no guarantee that they will continue in the future.
- Delegated school budgets are also under significant pressure with a forecast overspend of £3.1 million in 2019-20. This would see overall school reserves falling below zero at the end of the year. Such overspends by schools could add further pressure to the Council's financial position.

Response/Actions: The Council has consistently shown good financial management during difficult periods and is confident it will continue with this. It has a budget contingency to manage a limited amount of unforeseen budget issues and is also now putting in place specific review meetings with services where they overspend to understand the position and actions being taken. It continues to work hard with schools and many are now implementing 'deficit recovery plans' though the position has deteriorated since the WA review here.

(3) While the Council's delivery of planned savings has been strong in recent years, its ability to continue to deliver savings within demand-led services is becoming more challenging;

- the Council achieved 92% of its planned savings in 2018-19
- Education and social care accounted for the majority of the underachievement and those service areas contain some of the Council's major budget pressure areas

Response/Actions: The Council has a good track record in delivering savings and this is monitored carefully by Strategic & Corporate Management Teams

(4) The Council has a high level of useable reserves, although most are currently earmarked for specific use;

- We found that the Council has not previously made any unplanned use of reserves to fund revenue budget pressures and in recent years has increased its overall level of reserves. The Council has only started to use reserves from 2018-19 to balance its budget.
- While many of the reserve balances could be applied by the Council for alternative use if needed, they are to some extent already earmarked for a specific future purpose (other than the £6.5 million Council Fund reserve). Therefore, using such earmarked reserves could lead to planned future activity being curtailed or delayed, or risks being inappropriately managed, unless they were later replenished.
- Furthermore, the Council identifies that the following reserves from the above list are not readily available for alternative use: school reserves of £3.1 million (for the specific use of individual schools only), and capital receipts reserves of £8.3 million (largely limited to use on capital projects). This leads to a total of £91.1 million of 'usable reserves' which the Council could access, but would consequently have to manage the impact of such use

Response/Actions: The overall position on reserves is 'somewhat distorted' by the single earmarked PFI reserve which currently make up nearly 50% of total reserves and represents a pre-payment of grant by WG to fund a large part of the Council's PFI costs over the next c18 years. The Council has a good level of reserves and whilst these are virtually all earmarked, they do ultimately provide, in the last resort, some mitigation for overspending / funding. If this was to happen, then future projects, which were funded from these reserves, may not be able to progress or in using other reserves, budgetary provision would need to be made to 'repay' these, creating further pressure on the Council's medium term financial plan (MTFP). There are no

easy, impact free solutions through reserves but they do ultimately provide some cover/capacity in the last resort.

(5) While council tax represents a growing proportion of the Council's income, its level of arrears is increasing;

- We found that although the proportion of the Council's budget funded by council tax is increasing, council tax arrears have increased over time.
- Between 2008-09 and 2018-19, the Council has improved the amount of council tax it collects annually from 95.8% to 96.6%. Despite this improvement, council tax arrears have increased from £2.2 million in 2008-09 to £4.6 million in 2018-19, an increase of 109%. This compares to an increase in annual council tax debit of 69% over the same period. Over this period, in real terms the Council's arrears balance has fallen from the 4th lowest in Wales to the 12th lowest.

Response/Action: The Council has consistently raised more Council Tax cash over the last few years than budget. This is because of the in-year collection of Council Tax, which is below budget, but still reasonable, the collection of arrears and the growing tax base in the city. The current Covid-19 pandemic period is an on-going challenge to Council Tax collection and is being managed and reviewed.

The Head of Finance (HoF), with the revenues manager is currently developing an improvement plan in the revenues function & customer services to improve collection rates.

(6) In implementing its commercialisation strategy, the Council will need to manage risks associated with any increased borrowing.

- The Council's overall cost of borrowing in 2018-19 was 9.1% of its total net revenue budget, which was high in comparison with other Welsh councils
- The Council has made previous efforts to limit its borrowing as far as possible by using 'internal borrowing' (that is, using available internal resources first before borrowing from other entities). Over time, the Council will need to borrow from third parties to cover for previous internal borrowing, in order to fund its planned activity. Doing so will attract further interest costs in the medium to long term. The Council will therefore need to carefully consider the affordability of further interest costs when deciding whether to take on any further external borrowing above that already planned.
- In April 2019, the Council's Cabinet agreed a commercialisation strategy which aims to contribute to addressing the financial deficit that the Council faces. The strategy includes three main approaches:
  - current services provided on a more commercial basis;
  - new services being provided by the Council; and
  - property investment, both commercial and residential.
- The Cabinet agreed to examine each of these areas and to examine business cases before taking any decisions. It agreed in its Capital Strategy to establish a £50 million property investment fund to be funded via additional borrowing, but no such investments have yet been undertaken. The Cabinet recognised that such an approach creates additional financial risks with the significant increase in the Council's long-term debt and potential uncertainty around the return on any investments. Given these risks, Cabinet agreed a framework in which it will review and assess opportunities to assess the level of risk and benefit within agreed parameters.

Response/Action: The HoF will be preparing an updated Capital Strategy for the Council which will need to set out future borrowing limits for the Council and will need to be cognisant of, and address the relatively large borrowing levels the Council currently has. This will be approved as part of the 2021/22 budget process.

There have been no investments made in properties in pursuit of the commercialisation strategy and there is likely to be a change in borrowing rules from PWLB which will prohibit borrowing from the PWLB for this purpose. The current commercialisation strategy has not developed since

the departure of the previous Chief Executive who was going to drive this. In light of the above, the HoF will need to discuss how we progress this with the new Chief Executive and Leader of the Council.

## Financial Summary

There are no direct financial consequences stemming from the report here and the AW review. It confirms the Council is in a good position but has some issues it needs to address in the short to medium term.

## Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Findings of the report are not considered as part of further financial monitoring and reporting	Medium	Low	Regular monitoring and reporting of the Council's financial position and actions identified to manage key financial risks.	Corporate Management Team

## Links to Council Policies and Priorities

This work is aligned with the Council's Well-being Plan, Corporate Plan Well-being objectives and Strategic Recovery Aims.

## Options Available and considered

- a) To note the outcomes from the Audit Wales report and its findings;
- b) To disregard the contents of the report and its findings.

## Preferred Option and Why

The preferred option is (a) and for Cabinet to note the outcomes of the report and to be provided with regular updates on the progress of the service area implementing the necessary management actions.

## Comments of Chief Financial Officer

The review was carried out in 2019, utilising facts from previous financial years and the Council's balance sheet as at March 2019. The position since then has changed significantly with the onset of the Covid-19 pandemic which has put unprecedented pressure on Council finances across the UK. Audit Wales's initial plan was to prepare a national report on the whole sector but this has been delayed to this Autumn which can take account of the issues raised. In the meantime, the Council is working hard to manage the financial impacts of Covid-19 and this is reported through normal monitoring processes to senior management and Cabinet.

The AW report confirms that the Council has, in overall terms, a good financial position and manages its finances well. It highlights a number of issues which are challenging as the Council moves forward such as its relatively high level of debt, on-going overspending in demand led services and delivery of savings but more significantly, the need to develop a medium term approach to planning services / savings.

## Comments of Monitoring Officer

There are no specific legal issues arising from the report. The Report from WAO sets out their findings following a review of the Council's financial sustainability, in accordance with the overriding objectives of the Well-being of Future Generations (Wales) Act. The overall conclusion is that the Council is in a relatively strong financial position but further work is required to develop a more strategic and sustainable approach in the medium to long term. The cover report identifies key elements of the WAO findings and sets out proposed actions to address those issues. Cabinet are required to consider the report and the proposed actions, in exercise of their statutory role to oversee the effectiveness of the Council's internal controls and the administration of its financial affairs, and formulate any comments or recommendations.

## **Comments of Head of People and Business Change**

The Council welcomes the report from Audit Wales as part of our regulatory framework and there are no staffing / governance impacts raised in this report. As highlighted by the Head of Finance, the Council has demonstrated good financial management and prudence over the years and in this current administration which has involved both the Council's Cabinet and senior managers. With the impact of Covid 19 the Council has been careful to ensure services are managing their budgets effectively and raising any potential financial risks that could impact on the delivery of the Council's objectives and budget. As reflected across the Welsh public sector, medium to long term planning is a challenging area, and we will need consider the future Welsh Government's (WG) priorities and plans as we go into WG elections next year and local council elections in 2022

## **Comments of Cabinet Member**

The Cabinet Member has noted the findings of the Audit Wales report and management responses to implementing the necessary actions to improve the delivery of the service.

## **Local issues**

None

## **Scrutiny Committees**

Not Applicable

## **Equalities Impact Assessment and the Equalities Act 2010**

Not Applicable

## **Children and Families (Wales) Measure**

Not Applicable

## **Wellbeing of Future Generations (Wales) Act 2015**

The Councils financial sustainability is a key underpin for the Council in delivering on the requirements of the Act. In particular:

- Having a long term strategic approach to planning services within the funding /resources available
- Taking a long term approach to managing debt levels which will impact on the Councils finances in the long term
- Ensuring financial sustainability to secure development and delivery of essential services

These issues are being addressed, as needed, in the actions noted in the report

## **Crime and Disorder Act 1998**

Not applicable

## **Consultation**

Not applicable.

## **Background Papers**

Appendix 1 – Audit Wales Report August 2020 (Welsh)

Appendix 2 – Audit Wales Report August 2020 (English)

Dated: September 2020