

# Report

## Governance and Audit Committee

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### Part 1

**Date:** 11 November 2021

**Subject** **Audit Wales report – “Financial Sustainability Assessment - Newport City Council 2020/21”**

**Purpose** To present to the Audit & Governance committee the Audit Wales report on their ‘2020/21 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 which concludes that: “The Council has a good understanding of its financial position and recognises the need to transform its service delivery for future sustainability, although further work is required to design and implement these changes”

**Proposal** The Committee is asked to note the report and provide comments, as appropriate, on the report’s findings and the Council’s response within this report. These will be included in the subsequent Cabinet report on this review.

**Action by** HoF to include any comments and observations in the report to Cabinet on this review

**Timetable** Immediate

This report was prepared after consultation with:

- Leader of the Council as Cabinet Member for strategic finance
- Chief Executive
- CMT

**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. An overview of AW work completed in the first six months of this financial year is reported separately to the Audit Committee.

In 2020/21, 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 work undertaken built on a similar review undertaken during 2019/20.

In addition to the individual Council report, both at this Council and all others, AW have also now published a composite report on all Councils across Wales.

Locally here for Newport City Council, AW concluded that "The Council has a good understanding of its financial position and recognises the need to transform its service delivery for future sustainability, although further work is required to design and implement these changes".

The conclusion was based on findings across a number areas reviewed, which concluded:

1. The immediate impact of COVID-19 on the Council's financial sustainability has been funded by the Welsh Government
2. The Council has a financial strategy that quantifies the gap in funding for future years and continues to recognise the need for transformational changes in service delivery, although details of these changes are yet to be confirmed
3. Whilst the Council has reduced its usable reserves in the last year, they remain comparatively high, although most are earmarked for specific use and a significant proportion relates to future Private Finance Initiative obligations
4. The Council has consistently spent within its revenue budget over recent years
5. The Council has a good record of achieving savings but is finding it more difficult to identify future savings to balance its budget
6. The Council has a reasonable liquidity position to cover its immediate liabilities

The AW report is attached as Appendix 2 with Appendix 1 showing the underlying main issues and observations, taken direct from the report, for Members attention and information.

Whilst the report points towards a strong current financial position – a small number of important actions are required to address some of the issues highlighted; all of which were known to the Council and are either in progress or due to start. Most of the conclusions within the assessment are, not unexpectedly, the same / similar to those flagged up in the previous year's report but the Council's attention and efforts have been virtually wholly focussed on the Covid pandemic since then. In addition, the Councils senior management capacity has been significantly reduced over the last 12-18 months with key vacancies in place. The recent approved new Senior Management Structure and appointments into that has and will continue to improve this issue now and allow time and focus to address some of the key actions required.

The key actions include:

1. Development and implementation of a strategic approach and plan to closing the MTFP gap

The new role of Transformation and Corporate Director will allow appropriate time and focus to be given for this and work across the organisation to develop and implement a plan. Whilst not yet confirmed, it is likely that the Welsh Government will be given a multi-year funding settlement in the forthcoming Spending Review and this could allow it to do the same for Local Government. Whilst there will inevitably be some change over any period, this would provide more certainty to plan over the medium term.

As always, demand on the Council's budgets are significant and there are large potential risks and challenges on its budgets in the next few short years as we deal with the impacts of Covid. These will feature heavily in our work in this area.

## 2. Develop a sustainable Capital Programme and funding

The AW report flags up a potential financial sustainability risk due to its high revenue budget cost of 'capital financing', which will grow even higher as its internal borrowing reduces over the medium term. This issue was explained in the Councils capital strategy in February 2021 to both Cabinet and full Council. Whilst the Cabinet agreed revenue budget for the capital financing costs required to complete the current capital programme, sustaining the impacts of that if funding reduces / service pressures increase is a real risk.

The next capital programme period begins in 2023/24 and the current capital programme has very limited capital resources unallocated at this time and is strictly limited. The next programme will need to

- (i) show how it deals with affordability and sustainability in relation to future borrowing. Inevitably, this will need to focus on setting out appropriate limits on new borrowing commitments which stabilise/reduce the Councils longer term Capital Financing requirement (CFR) - that is, its requirement and commitment to future external borrowing, which has grown significantly in recent years,
- (ii) limit / keep the current programme borrowing requirement to what is already set out in its capital and treasury strategies.

Work on putting together the new programme will develop over the 2022/23 financial year.

It is likely that even in a position where the CFR is stabilised and even reducing over the medium term, the annual revenue budget cost of capital financing will increase still and was shown and explained in the February reports mentioned above. Key decisions on this will be required over the next 12 months or so, within the context of on-going significant demand for capital resources and, currently, uncertain future funding and service pressures.

## Financial Summary (Capital and Revenue)

There are no direct financial impacts resulting from this report which deals with the AW assessment of our financial strength and related issues. As noted, that assessment has concluded that the Council is in a good position in relation to this.

## Risks

<b>Risk Title / Description</b>	<b>Risk Impact score of Risk if it occurs* (H/M/L)</b>	<b>Risk Probability of risk occurring (H/M/L)</b>	<b>Risk Mitigation Action(s)</b> What is the Council doing or what has it done to avoid the risk or reduce its effect?	<b>Risk Owner</b> Officer(s) responsible for dealing with the risk?
Findings of the report and action plan	High	Low	Strengthened Senior Management structure	Strategic and Corporate

outlined are not considered and implemented as part of on-going work			<p>Specific Director role focussed on transformation</p> <p>Shared understanding and acceptance of challenges in capital financing and current levels of borrowing</p> <p>Regular monitoring and reporting of the Council's financial position and actions identified to manage key financial risks.</p>	Management Team
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\* Taking account of proposed mitigation measures

### 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

The Committee is being asked to consider and provide any comments on the conclusions reached and action plan only. These will be forwarded to Cabinet in due course for decisions.

### Preferred Option and Why

N/A

### Comments of Chief Financial Officer

The report confirms that the Council has a good level of financial resilience and has managed its finances well over the years.

In terms of the issues highlighted, most have actions already in progress or are part of on-going processes e.g. monitoring delivery of savings, the impact of using reserves outside of their intended uses. There are two notable areas where further work is required and are highlighted in the body of the report, being the development of a change/transformation programme which delivers financial sustainability / balanced MTFP and managing the Councils future capital financing risk.

### Comments of Monitoring Officer

This section **MUST** be completed by the Head of Law & Regulation before the report is submitted to any elected member for consideration. The Head of Law and Regulation will discuss any legal procedural or constitutional issues related to the proposed decision

You will have consulted the Head of Law & Regulation to complete the 'Background' section above. This section should confirm that has been done and that the Head of Law & Regulation is comfortable with the proposals.

### 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 priorities of the Council as we go into the local council elections in 2022.

Newport Council welcomes the findings from Audit Wales, recognising the challenges and opportunities that the Council has as we recover from the pandemic. Newport Council's Cabinet and senior managers throughout the last five years have been managing the Council's finances to ensure

## **Scrutiny Committees**

N/A

## **Fairness and Equality Impact Assessment:**

- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**
- **Welsh Language (Wales) Measure 2011**

the Committee is being asked to consider and provide any comments on the conclusions reached and action plan only. These will be forwarded to Cabinet in due course for decisions. There are no policy decisions required from this report and therefore no Fairness and Equality Impact Assessment required.

## **Consultation**

N/A

## **Background Papers**

N/A

Dated: 14/10/2021

## **APPENDIX ONE – SUMMARY OF ASSESSMENT AND KEY OBSERVATIONS / FINDINGS**

### Overall

The Council has a good understanding of its financial position and recognises the need to transform its service delivery for future sustainability, although further work is required to design and implement these changes

### Key areas of review and observations / findings

#### **1. Covid -19**

##### **The immediate impact of COVID-19 on the Council's financial sustainability has been funded by the Welsh Government**

- the Council quickly set Strategic Recovery Aims in response to the COVID-19 pandemic that make explicit its priorities. The Council has used its existing governance framework to manage the delivery of these additional Strategic Recovery Aims.
- when preparing its financial plans, the Council has maintained a general contingency of £1.5 million within its revenue budget as a safeguard for unknown costs (in line with the approach taken in previous years). On top of this, it has forecasted the potential impact of the COVID-19 pandemic through reduced revenue and additional costs. The Council has taken this approach in previous years and has achieved small underspends in recent years.

#### **2. Financial Strategy**

##### **The Council has a financial strategy that quantifies the gap in funding for future years and continues to recognise the need for transformational changes in service delivery, although details of these changes are yet to be confirmed**

- in August 2020 we reported that 'the Council did not have a sustainable strategy to support financial resilience and sustainability over the medium term'. Also, that 'the Council has recognised that in order to achieve the necessary savings between 2020-21 and 2022-23 it will need to take a different approach to that which it has used to date. The Council has indicated that it plans to undertake a root and branch review of its eight service areas to help increase its financial resilience'.
- the Council had an 'Invest to Save' usable reserve of £9.9 million at March 2020 set aside for additional costs to finance a transformational programme to move towards a more financially sustainable delivery of services model. Understandably, the Council's focus on responding to the COVID-19 crisis has prevented further progress being made in the last year.
- to inform financial planning and identify their projected funding gaps, all councils make assumptions about factors that will impact on the amount of funding they will have available in future years. The Council sets out financial assumptions within its Medium Term Financial Plan (MTFP) produced in January 2021
- in August 2020 we reported<sup>2</sup> that: the Council receives over half of its total revenue from the Welsh Government's revenue support grant (RSG). At the time of our fieldwork for that report, the Council projected a funding gap of £21.8 million for the three years 2020-2023. Since then, the actual increases in RSG have been significantly higher than the Council's projections. Consequently, the Council now projects a significantly smaller funding gap of £5.5 million for the next three years, being 2021-2024

#### **3. Reserves**

**Whilst the Council has reduced its usable reserves in the last year, they remain comparatively high, although most are earmarked for specific use and a significant proportion relates to future Private Finance Initiative obligations**

- when considering the usable reserves held by the Council at the end of 2018-19, in August 2020 we reported that the Council had a high level of usable reserves, although most were earmarked for specific use.
- at the end of 2019-20 the Council's usable reserves were reduced from £94.7 million in 2018-19 to £78.8 million, mainly with transfers to the General Fund from Usable Reserves for: Bad debt provision; Insurance; Schools; Capital Expenditure; and Invest to Save.
- according to its 2019-20 Statement of Accounts the Council held a total of £78.8 million in usable reserves, consisting of:
  - £44.2 million of 'smoothing reserves', set aside by the Council to smooth funding variations over time (£42.3 million of this relates to two PFI schemes to be unwound over the next 17 years);
  - £17.1 million of 'enabling reserves', retained for potential future investment including an Invest to Save reserve of £9.9 million;
  - £4.8 million of 'risk reserves', held to mitigate against specific risks identified by the Council;
  - £6.5 million of Council Fund, available for any purpose;
  - £5.0 million of 'other reserves' for specific projects/issues; and
  - £1.1 million of reserve balances relating to individual schools.

while many of the above reserve balances could be applied by the Council for alternative use, they are to some extent already earmarked for specific future purposes (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 risk being inappropriately managed. Some reserves (such as the PFI smoothing reserve) are also being currently used and so would need to be replenished urgently if drawn upon

#### **4. Financial Management**

**The Council has consistently spent within its revenue budget over recent years**

- In August 2020, we reported that while the Council had 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 January 2021, the Council forecast an underspend of £2.7 million on its revenue budget for 2020-21, largely as a result of the COVID-19 pandemic, to: temporary school closures; lower demand for its adults' social care services; and not needing to draw upon the £1.5 million contingency. Despite this underspend, the report details service areas where financial pressures remain and emphasises the need for continued remedial action and potential for this position to worsen. The Council's arrangements enable it to closely manage the financial performance of service areas and therefore to respond within year to notable under and over spends.
- The Council has recently added further commitments to its capital programme. Whilst these decisions are well understood and arrangements are in place to closely monitor progress, these capital investments increase the borrowing costs for the Council. These costs have been budgeted for but place increased strain on the Council's revenue budget, which could inhibit the Council's ability to respond effectively to potential future funding cuts or expenditure pressures.

#### **5. Delivering budget savings**

**The Council has a good record of achieving savings but is finding it more difficult to identify future savings to balance its budget**

- In August 2020, we reported that 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.

- Whilst the Council's MTFP does set out some savings plans over the four-year period, these do not fully bridge the funding gap after 2020-21.
- The Council reported to its Cabinet in January 2021 that implementation of its planned savings had been delayed due to the COVID-19 crisis. The delays are both detailed and quantified

## **6. Liquidity**

### **The Council has a reasonable liquidity position to cover its immediate liabilities**

- in one of the last five years spanning 2015-2020, the value of the Council's current assets was less than its current liabilities
- the notable fluctuation in the value of Current Assets and Liabilities in 2015-2018 was due to the funding and completion of Friars Walk.