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Archwilydd Cyffredinol Cymru
Auditor General for Wales

Savings Planning in Councils in Wales

WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

I have prepared and published this report in accordance with the Public Audit (Wales) Act 2004.

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Mae’r ddogfen hon hefyd ar gael yn Gymraeg.

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Summary

1 Good financial management is essential for the effective stewardship of public money and the delivery of efficient public services. The current financial climate, with ongoing reductions in the funding for local government, means that good financial planning, with well-considered savings plans, is critical to councils' financial resilience.

2 Good financial planning:

- helps councils take the right decisions for the short, medium and long term;
- helps councils deliver services to meet statutory obligations and the needs of local communities;
- is essential for good corporate governance;
- is about managing performance and achieving strategic objectives as much as it is about managing money;
- underpins service quality and improvement;
- is the basis of accountability to stakeholders for the stewardship and use of resources; and
- is a key management discipline.

3 Financial planning for the medium to long term involves understanding the future demand for public services, assessing the impact of probable changes, reviewing the gaps between funding needs and possible income and, where necessary, developing appropriate savings strategies. There should be very clear links between a council's medium-term financial plan and the annual budget that the council approves. Although most councils only approve the budget for a single year, this single-year budget should be supported by indicative future spending plans that forecast the impact of relevant pressures for councils. Presenting a budget for a single year in isolation does not allow councillors to fully scrutinise the implications of spending decisions. A council's strategic priorities and its financial health should be the basis for deciding what is practicable. Well-considered long-term financial strategies and medium-term financial plans can ensure the delivery of strategic priorities by enabling appropriate financial choices to be made.

4 Councils receive about 80% of their net income from the Welsh Government; the exact amount is only known four to five months before the start of the financial year. We recognise the challenges that public bodies face with annual funding settlements in updating their medium-term financial plans and ensuring they have long-term financial strategies in place. However, the absence of firm funding forecasts should not prevent councils projecting likely future income and spending requirements, and planning accordingly. Councils can use a range of information to anticipate changing circumstances, set priorities, make choices and manage service delivery. They can calculate how much they would need to deliver services (at current or future prices) and review alternative income and spending scenarios to identify gaps and prepare for the future by investigating different approaches.

5 Wales Audit Office staff, on behalf of the Auditor General, have previously, during 2015-16, undertaken work at all 22 councils in Wales to assess the adequacy of their financial planning, control and governance arrangements. As well as providing a local report to each council, we summarised our findings in a national report, Financial resilience of local authorities in Wales, published in August 2016. That work found that councils have had difficulty in developing and delivering the savings and changes to services at the pace required to ensure their future financial resilience.

6 We have now followed up that earlier work, with a review undertaken between June and September 2016 focusing specifically on how councils identify, plan for and deliver savings. We examined their financial planning arrangements, the extent to which councils in Wales achieved their 2015-16 savings plans and the work they did to ensure robustness of their 2016-17 savings plans.

7 In this report we have described some key characteristics of effective financial planning – what good looks like. Auditors have used these and other factors to reach a balanced view on the effectiveness of each council's financial planning arrangements across Wales and to evaluate the ability of councils to deliver their medium-term financial plans and their planned savings.

8 The basic premise of the review is how well savings planning supports financial resilience. The more successful each council is at delivering its planned savings in the timeframe it predicts the greater the contribution savings planning has to the financial resilience of the council. Whilst effective savings planning is not the only factor which supports financial resilience, it is a key contributing factor. Other factors include, for example, asset management strategies, effective workforce planning, income-generating strategies, reserve strategies and a council's approach to collaborative opportunities.

9 Overall, we concluded that **medium-term financial planning in councils is generally effective but shortcomings in savings planning present a risk that some councils will not achieve the savings they need to make**.

Proposals for improvement

10 It would be unusual if we did not find things that can be improved and, where we do, the Auditor General can take a variety of steps. Within this review we issued a range of proposals for improvement within our individual local report to each council. The main messages[1] within our local reports and the frequency that they featured are summarised below and we would expect councils to take steps to address them and any others where they appear in their individual report.

Exhibit 1: proposals for improvement made to councils in the course of this review

Most frequently made proposals for improvement	Number of times issued
Strengthen financial planning arrangements by ensuring that savings proposals are fully developed, risk assessed and include realistic delivery timescales prior to inclusion in the annual budget	14
Strengthen financial planning arrangements by developing indicative savings to cover the period of the MTFS	10
Strengthen financial planning arrangements by developing an income generation/charging policy	10
Strengthen financial planning arrangements by integrating and embedding financial and corporate planning processes	5

1 Exact wording has been summarised here to capture the key message of the proposals made in local reports.

Medium-term financial planning in councils is generally effective but shortcomings in savings planning present a risk that some councils will not achieve the savings they need to make

Part 1 - Context

1.1 Since 2010, the UK government has reduced spending on public services as part of its plan to reduce the deficit. With cuts to its budget, the Welsh Government has had to make difficult choices as to how to allocate those funding cuts across devolved public services. As a result, the amount of core funding made available by the Welsh Government to councils has reduced each year. So far, councils have managed to reduce expenditure and balance their budgets, but the scale of annual budget reductions is likely to continue. Our analysis shows that between 2013-14 and 2016-17, there has been a real-terms reduction of £483 million (10.9%) in this core funding[2].

1.2 The real-terms reduction has varied between councils for a number of reasons; for example to reflect factors such as population change, deprivation factors and rurality. As a consequence, some councils received a reduction of just over 6%, whilst others in the region of 13.5%.

Exhibit 2: percentage real-terms reduction in Welsh Government support between 2013-14 and 2016-17

10.9%

real-terms **reduction** in the amount of money from the Welsh Government since 2013-14.

Source: StatsWales

2 Comparing core funding (Aggregate External Finance (AEF)) across the period 2013-14 to 2016-17 is complicated for two main reasons. Firstly, the Welsh Government has incorporated grants into its core funding that were previously provided separately. While this 'de-hypothecation' of grants results in an increase in core funding, it is not necessarily a net increase in funding. The net value of grants incorporated into core funding since 2013-14 is around £76 million in real terms (adjusted for inflation).

1.3 The impact of leaving the European Union provides considerable uncertainty for the UK public sector. The Welsh Local Government Association has expressed concern over the implications of the European Union referendum outcome, calling it a 'seismic change in UK public policy'[3] especially as councils are collectively the largest employer in Wales and the deliverer of many important public services.

1.4 Notwithstanding the ongoing reduction in their funding, councils have been expected to protect schools and social care from the bulk of the financial cuts. Social care, in particular, has struggled even with this protection as demographic changes have led to increased demand on these services. This protection has meant that other services have borne the majority of the cuts and have seen reductions in budgets of 30% or more in real terms since 2013-14.

3 Welsh Local Government Association, **Councils voice concern over service impacts of EU referendum**, 24 June 2016

Part 2 - Financial planning arrangements

The majority of councils have an effective approach to forecasting their funding gaps but some have limited indicative savings proposals which undermines their medium-term financial plans

What good looks like

2.1 The medium-term financial plan is a key component of an effective, integrated corporate planning framework. Good medium-term financial planning and annual budgeting reflects a council's strategic objectives and priorities for the year, and over the longer term. Medium-term financial plans typically span a three-to-five-year period and identify the allocation of resources to delivery of services and the council's priorities. The medium-term financial plan should include consideration of the impact on citizens and other stakeholders.

2.2 Good medium-term financial plans include consideration of key financial risks together with their mitigation. Councils have to make assumptions around inflation, income levels, demographics, future demand for services and the costs of delivering services based on reasonable predictions. Councils should also use financial modelling to assess the likely impacts on financial plans and required savings for a range of different scenarios and risks. The medium-term financial plan should be reviewed frequently and updated to reflect changes in assumptions and risks.

2.3 Councils should operate within a level of reserves and balances (including earmarked reserves and the general fund balance), approved by councillors, and appropriate to the strategic, operational and financial risks it faces. Councils should include details on how reserves will be used over the period of the medium-term financial plan.

2.4 Councils must demonstrate that they understand sources of income and the risks arising from these, and that they have reviewed approaches to managing fees and charges, to achieve value for money. Our national report, Charging for services and generating income by local authorities, published in November 2016, recognises that, whilst the legal basis for setting and managing charges is complex, councils are not always strategic in their approach to charging and that few councils were forecasting income levels beyond a one-year period.

What we found

2.5 In our previous review, undertaken in 2015-16, we found that councils' medium-term financial plans were generally not well aligned with other key strategies, and the quality, robustness and currency of medium-term financial plans was variable.

2.6 In this review we found that the majority of councils have improved and now have an effective approach to forecasting the savings they need to achieve, but there is still more for councils to do in planning how they intend to bridge the funding gap that they have identified, weakening their medium-term financial plans.

2.7 All councils now have medium-term financial plans which span a three-to-five-year period, underpinned by reasonable and realistic macro-economic, demographic and financial assumptions. Twenty councils formally update their medium-term financial plans biannually with more frequent updates being provided to executive boards and senior management teams during the year. The more comprehensive plans include sensitivity analysis, scenario planning, risk assessments and planned use of general and earmarked reserves over the plan period.

2.8 Whilst medium-term financial planning has improved, we found that half of the councils still do not fully align financial planning with wider corporate planning arrangements. This means that resources may not be allocated in line with councils' corporate priorities and a lack of links to other key strategies such as asset management and workforce planning weaken councils' financial strategic planning arrangements. We found that 11 councils clearly show the allocation of their budget across corporate priorities so that they can track the allocation of resources to corporate priorities over time.

2.9 Twenty councils model their financial forecasts for the budget gap on funding from the Welsh Government based on latest information and a range of 'least to most optimistic' scenarios. The final local government settlements for 2016-17 and 2017-18 were better than councils originally anticipated, although still a reduction. In 2016-17, one or two councils used the better-than-anticipated settlement to create earmarked reserves to support future financial resilience and service changes, and/or to reduce the level of council tax increase. However the vast majority of councils decided to reduce their in-year savings requirement.

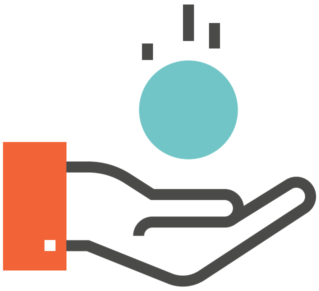
2.10 As a result, three councils have arrived at a more optimistic forecast funding scenario for 2018-19 onwards on the basis that future settlements will continue to be more favourable than anticipated. This assumption has led them to reduce their planned savings requirement over the medium term. More prudently all other councils have recognised the risk that this may not be the case and continued to plan for a greater level of saving in the medium term.

2.11 Twenty councils identify the budget gap over the period of the medium-term financial plan, the savings requirement to meet the gap supported by high-level outline indicative savings proposals. However, only two councils are able to demonstrate that they have more detailed proposals in place to meet future savings requirements. All councils recognise the majority of savings required in the future will probably come from service change and new ways of working. These type of savings usually have longer lead-in times. We found that all councils have strategic change management programmes which include these types of longer-term savings proposals. Whilst two councils have detailed or indicative savings plans to support these savings proposals, all others have set global targets for planned cross-cutting and collaborative reviews of services. We found in this review, and our previous financial resilience reviews, that councils continue to experience difficulty in developing and delivering savings plans of a transformational or cross-cutting and collaborative nature within the timescales they have planned.

2.12 All councils have a reserves strategy or a protocol in place for managing reserves that includes a clear rationale for their use. Under three quarters of councils report biannually on the use of reserves, normally when setting the annual budget and closing the annual accounts. Of these councils, the majority provide additional updates in routine financial monitoring reports. We found that in 2015-16, 13 councils reviewed and re-designated a number of earmarked reserves resulting in investment in corporate priorities and other initiatives to deliver future budget savings. Whilst reserves are usually reviewed regularly, we found that less than half of councils included a statement of the projected use of earmarked and general reserves over the period of their medium-term financial plans.

2.13 In our previous review we commented that councils had managed to increase, or at least maintain, reserve levels despite having to reduce budgets to absorb funding cuts. We questioned how sustainable this would be going forward. In this review we found that councils have managed to sustain the position. Our analysis of council reserves taken from our review of councils' statements of accounts shows that the overall level of earmarked and general revenue reserves (excluding delegated school balances) increased by £40.4 million (3.9%) in 2015-16 from 2014-15 (earmarked reserves increased by £37.8 million and general reserves increased by £2.6 million).

Exhibit 3: across Wales, councils have collectively been able to maintain reserves between 2015-16 and 2016-17



£40.4m

minimal change in reserve levels between 2014-15 and 2015-16.

Source: councils' statements of accounts

2.14 Fifteen councils have fees and charges registers, and make revisions to fees and charges when setting the annual budget and some include income-generating proposals in their medium-term financial planning assumptions. Less than half of councils have an explicit income generation and charging policy and in the majority that do, we found that awareness and application of the policy by services within these councils was mixed. Ten councils were able to demonstrate that they had corporate-wide strategies for managing charges, and were in the process of reviewing income streams and identified some new income streams. In our November 2016 report, Charging for services and generating income by local authorities, we reported that whilst councils are beginning to develop corporate-wide strategies for managing charges, progress had been slow. As part of this review, we found that progress in this area remains slow.

Part 3 - Savings plans

Over half of councils have well-considered and effective savings plans for 2016-17 but the others do not and they may fail to achieve their in-year savings targets

What good looks like

3.1 Councils that deliver savings effectively have well-considered savings plans that sit within longer-term savings strategies which are underpinned by well-developed fully costed individual savings and delivery plans aligned with the medium-term financial plan. These councils have robust monitoring arrangements in place and do not have to continually bridge the gap year on year by identifying alternative savings, using unplanned one-off funding from earmarked reserves, general reserves, contingency funds or fortuitous unplanned income received during the year.

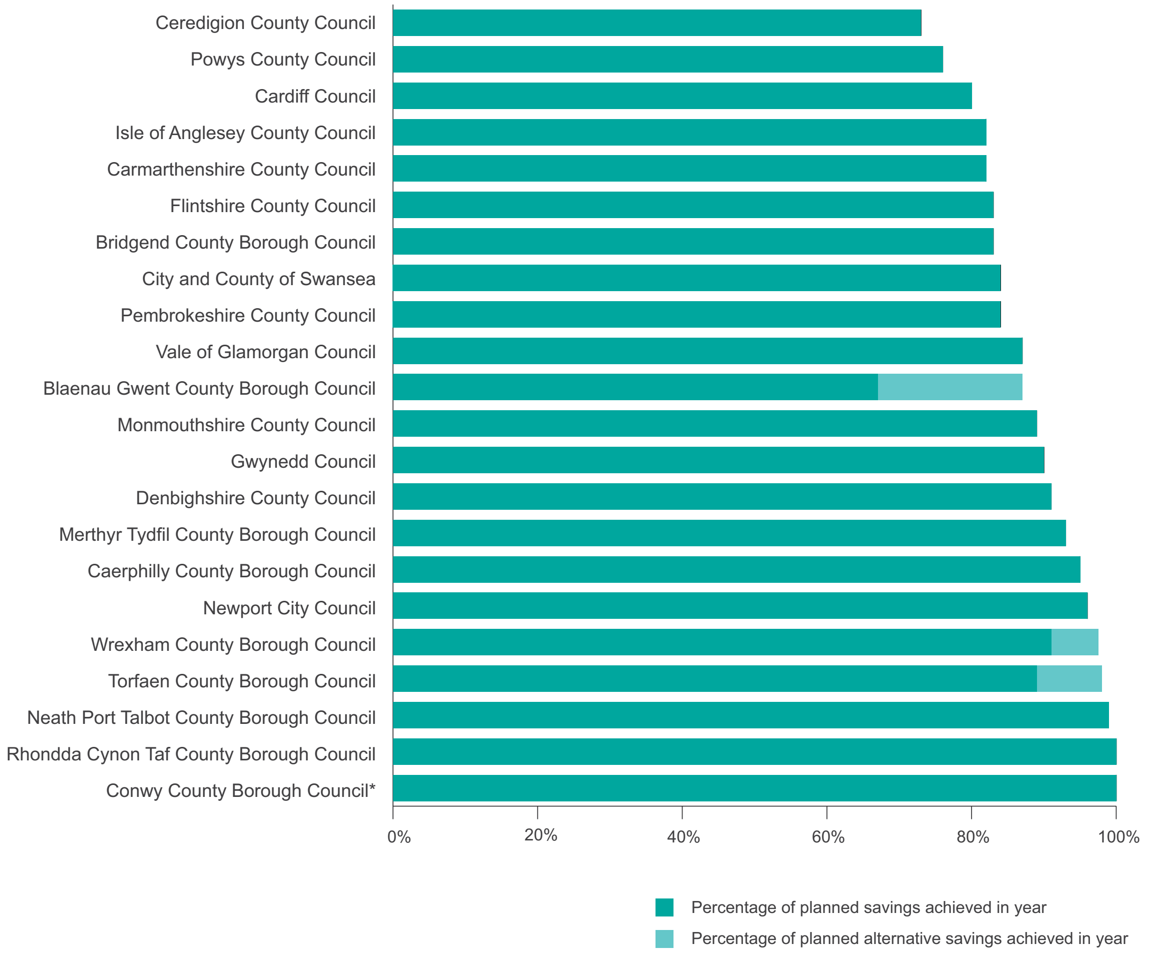
What we found

3.2 In our earlier 2015-16 review of financial resilience, we found that whilst councils delivered balanced budgets in 2014-15, the majority did not have well-developed savings plans with appropriate actions and they struggled to deliver intended savings. Around one-third of councils used general or earmarked reserves to meet any shortfall between income and expenditure.

3.3 In this latest review, we found that all councils again delivered a balanced budget in 2015-16, but not necessarily as planned. Councils used a variety of methods to balance their budgets which included use of reserves, underspends from within other service areas, and unplanned income. Councils, collectively, planned to save £251.6 million in 2015-16. The total level of savings achieved by councils, which includes planned alternative savings, was £221.5 million (88%). Individual councils achieved between 73% and 100% of their planned savings during 2015-16 with two councils achieving 100% and 12 less than 90% as shown in Exhibit 4.

3.4 Councils with higher in-year savings achievement rates generally included well-developed proposals in the annual budget. These were well thought through, fully costed and often low-risk items. The majority of these councils also held, as a planned contingency measure, either alternative approved savings proposals which could be substituted if necessary, or a central contingency budget within the base budget.

Exhibit 4: percentage of savings (£) achieved by councils in 2015-16



Note

* Whilst the council is able to demonstrate what it has achieved overall, it does not report a complete analysis of the full savings plan – this is because the council does not specifically monitor each and every saving line, but monitors the total budget for each service block.

Source: Wales Audit Office Savings Planning Review 2016-17

3.5 Over two-thirds of councils reviewed their 2015-16 savings plans, but the extent and depth of reviews, and the approach taken by councils, varied. The main reasons for non-achievement of specific savings plans related to circumstantial changes, over-ambitious savings targets which were not underpinned by robust delivery plans, and changes in political appetite. Seventeen councils recognised the value of specific unachieved savings proposals from previous years as a pressure in the following year's budget. Where councils have carried forward previous years' unachieved savings proposals, they expect services to identify alternative interim savings to compensate for any shortfalls.

3.6 There is a statutory requirement for councils to approve their minimum revenue provision[4] policy annually. In 2015-16, at least four councils approved changes to their minimum revenue provision policy which resulted in re-profiling the minimum revenue provision charge to deliver savings in their medium term budgets and a significant saving in year one of the approved change to the policy. Three of these councils used the 2015-16 year one saving to reduce their savings requirement or to offset unachieved savings plans and balance their budgets in 2015-16, whilst the other council earmarked the year one saving for future use.

3.7 A few councils applied to the Welsh Government for a capitalisation direction to treat revenue costs associated with employee severance costs and change management proposals as capital expenditure. This approach helped those councils to either alleviate pressures on their 2015-16 revenue budget or/and reduce the need to draw on earmarked or general reserves.

3.8 In our previous 2015-16 review of savings plans, we found that when the annual budget was agreed, councils' savings plans included a mixture of fully developed plans, implementation plans at the development stage, and plans yet to be developed. The picture across Wales was variable and ranged from some councils having robust delivery plans to support savings plans, with others having few fully developed savings plans in place. The main weaknesses in savings plans included a lack of specific costings, a lack of clear delivery timescales, and poor integration with service and business plans.

3.9 In our review of 2016-17 savings plans, we found that 17 councils now align the annual savings plans with their medium-term financial plans. However, around one-third of councils did not have fully developed delivery plans in place to support all savings plans included in their 2016-17 annual budgets.

4 The MRP is the means by which capital expenditure financed by borrowing or credit arrangements is paid for by council tax payers. It is an annual amount which is charged against the revenue budget to meet the repayment of debt principal for loans and credit arrangements. The council can decide how it spreads the cost of the debt over the years, provided that it acts prudently.

3.10 Just over one-third of savings plans in councils were not specific or measurable. For example, eight councils included global savings targets relating to themed cross-cutting service and corporate reviews, for allocations to services once the reviews are completed. At the date our fieldwork was completed, we found that seven of these councils had not started or completed reviews and reported that the global savings targets included in the annual budget were unlikely to be achieved in 2016-17. Councils' estimated forecasts for 2016-17 savings achievements at 30 September 2016 ranged between 65% and 100%.

3.11 Around one-third of councils did not risk assess the likely achievement of individual savings proposals when agreeing the annual budget. Councils which did this prudently included a specific corporate contingency figure in the base budget to mitigate the impact of non-achievement. All councils are able to meet the more traditional-type efficiency savings within planned timescales but find it more difficult to achieve savings relating to change programmes within the estimated timescale.

3.12 All councils demonstrated through the use of impact assessments, that they had considered the potential positive or negative impact of proposals on its residents; the majority of councils had also considered the impact of the Well-being and Future Generations (Wales) 2015 Act.

3.13 Half of Welsh councils demonstrate that they are able to consistently achieve the majority of planned in-year savings and have either increased the savings achievement rate or retained a high rate. Conversely, the remaining councils are achieving consistently lower rates for in-year savings plans with little or no increase between financial years. Consequently, these councils have to either find alternative savings in-year or use one-off funding from other sources to balance their budgets.

3.14 Our review reinforces the concern which we have raised in previous years' reports that failure to achieve planned in-year savings places a strain on budgets which may be unsustainable. With the majority of future savings likely to come from service change and new ways of working, which are harder to achieve and require longer lead-in times, this situation may worsen and compromise councils' financial resilience in the longer term.

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