

Financial Sustainability Assessment – Torfaen County Borough Council

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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 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 2019-20¹, 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**². 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 during January 2021 to March 2021.

¹ Audit Wales, [Financial Sustainability Assessment – Torfaen County Borough Council](#), April 2020

² Audit Wales, [Financial Sustainability of Local Government as a Result of the COVID-19 Pandemic](#), October 2020.

Proposal for improvement

Exhibit 1: proposal for improvement

The table below sets out the proposal for improvement that we have identified following this review.

Proposal for improvement	
Proposal for improvement heading	
P1	To bridge its estimated funding gap and contribute to strengthening its financial sustainability the Council should; <ul style="list-style-type: none">• develop and deliver a programme of sustainable planned savings over the medium term, including the financial benefits arising from the delivery of its T22 transformation programme.

As a result of the better-than-expected Welsh Government budget settlements in the last two years the Council is now better placed to maintain its financial sustainability over the short term, but challenges remain over the medium term

The immediate impact of COVID-19 on the Council's financial sustainability has been assisted 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.

What we found

- 8 During 2020-21, the Council closely monitored and regularly reported its revenue and capital budgets, including the additional costs and lost income as a result of the pandemic as set out in **Exhibit 2** below. Additionally, the Council made key decisions in redirecting resources to support service delivery during the year.
- 9 To inform its financial planning, the Council developed initial estimates of the potential for additional costs and lost income for the 2021-22 financial year, for example, enhanced cleaning regimes in schools and lost school-meal income.
- 10 In its March 2021 budget paper for 2021-22, the Council³ stated that it was 'too early to identify sensible forecasts' of the medium-term impact of the pandemic on its financial position.
- 11 Council officers told us, however, that the emerging impacts of the pandemic on the Council's financial position will be monitored closely through its existing robust reporting mechanisms and consequently reflected in future medium-term financial plans.
- 12 In light of the potential impact of COVID-19 on residents the Council, as part of the budget for 2021-22, adjusted the assumed Council Tax collection rate when setting its tax base and will also review its fees and charges policy.

³ Torfaen County Borough Council, Budget 2021/22 and Medium-Term Financial Plan, Council 4 March 2021

Exhibit 2: the cost to the Council of COVID-19 over 2020-21 (Council estimate April 2021)

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.	£11.6 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£3.5 million
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.	£14.7 million
The cost to the Council of COVID-19 over 2020-21 after extra funding from the Welsh Government is taken into account.	£0.4 million

The Council continues to have a well-developed medium-term financial plan and recognises the increased importance of regularly reviewing its strategy as it manages the recovery from the COVID pandemic

Why strategic financial planning is important

- 13 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.

What we found

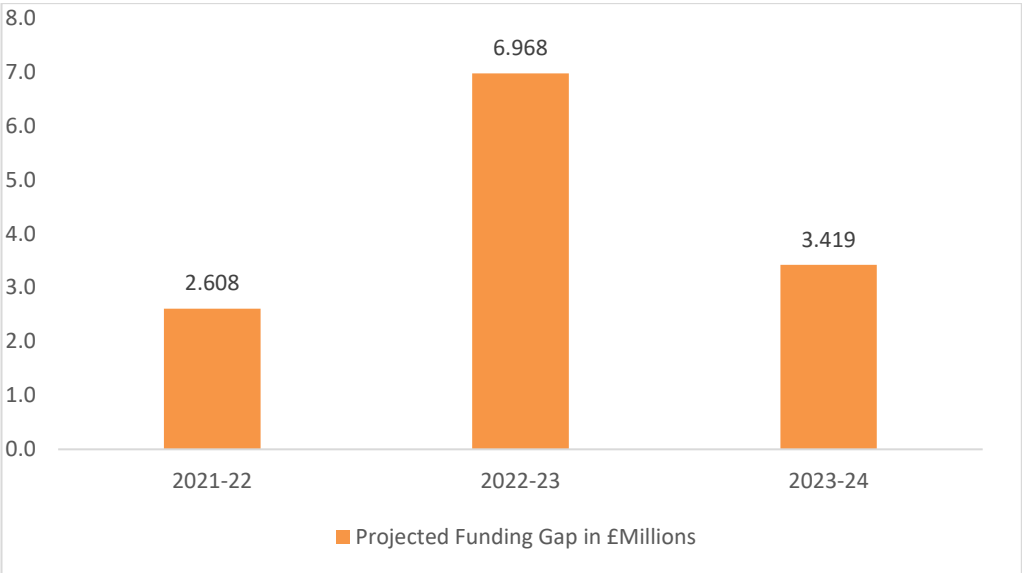
- 14 In our 2019-20 Financial Sustainability report we found that the Council's challenge in setting a balanced budget for 2020-21 had been eased by an improved settlement from the Welsh Government. We also found that the Council's future financial strategy relied significantly, but not exclusively, upon savings from its

transformation programme (T22) the financial benefits from which were still being worked through. Therefore, the Council's financial plan was still to be finalised.

- 15 In 2019-20, we found that the Council had a robust approach to budget planning that had enabled investment to be made in the key areas of children's services and education for 2020-21. We also noted that the Council's executive and senior officers had a clear and shared understanding of the Council's substantial current and future financial challenges.
- 16 Senior council leaders and senior officers continue to have a clear and shared understanding of the Council's current and future financial challenges.
- 17 The Council continues to have a well-developed medium-term financial plan (MTFP) covering the years 2022-2026 which identifies a projected funding gap for the four years 2022-23 to 2025-26 of £14 million.
- 18 **Exhibit 3** shows the Council's funding gap over the next three years. In setting a balanced budget in 2021-22, the Council approved savings measures (excluding schools) of £2.6 million.

Exhibit 3: the Council's projected funding gap for the three years 2021-22 to 2023-24

This graph shows the funding gap that the Council has identified for the following three years⁴.



⁴ Sources:

2021-22 - Torfaen County Borough Council Full Council 4 March 2021, Budget Book 2021-22 and Budget mitigations 2021-22
2022-23 and 2023-24 - Torfaen County Borough Council Full Council 4 March 2021, Medium Term Financial Plan 2022-2026

- 19 The MTFP identifies clearly the key internal and external risks to the Council's financial sustainability.
- 20 The Council is aware of its current key significant budget pressures which are pay inflation, children's social care, in particular, placements, as well as education and neighbourhoods.
- 21 The Council's 2021-22 budget provided additional revenue funding to those areas facing current budget pressures.
- 22 The key aspects of the Council's approach to bridging its estimated funding gap include the effective delivery of its T22 transformation programme, the effective management of annual budgets and effective delivery of planned savings.
- 23 Our review identified that officers and members were clear about the need to regularly review the Council's approach to mitigating the financial impact of the pandemic as that emerges during 2021-22 and potentially beyond.
- 24 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's assumptions in its MTFP are comprehensive and provide a balanced forecast at the time of its publication when compared with the assumptions made by all councils across Wales.

Whilst the Council's level of usable reserves has increased in 2020-21, it recognises the importance of using reserves strategically to strengthen its financial resilience in the medium term

Why sustainable management of reserves is important

- 25 Healthy levels of usable reserves are an important safety net to support financial sustainability. As well as being available to fund unexpected funding pressures, usable 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.

What we found

- 26 In our 2019-20 Financial Sustainability report we found that the Council's historically low levels of usable reserves had been reducing steadily over the previous few years and, whilst they were anticipated to reduce further by 2020-21, this was not sustainable.
- 27 As shown in **Exhibit 4**, the Council's level of usable reserves reduced at the end of 2019-20 to £16.7 million from £18.7 million at the end of 2018-19.

- 28 At the end of 2020-21, the Council's level of usable reserves increased by £8.7 million, of which £6 million is due to an increase in school balances. The Council has also established a specific reserve of £1.2 million to support its post-COVID recovery initiatives.
- 29 The Council's budget for 2021-22 includes specific use of reserves (£0.49 million) to support the implementation of the children's services transformation programme to help strategically and sustainably address the financial pressure it faces in this area.
- 30 The Council continues to recognise that with historically low levels of reserves, effective financial management and control are needed to ensure that reserves are not used in an unplanned manner or to support revenue budgets.
- 31 The Council also acknowledges that when using reserves in a planned manner, it needs to ensure that it achieves the intended outcomes through that strategic use of one-off funding.

Exhibit 4: amount of reserves versus annual spend

This exhibit shows the amount of usable 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.

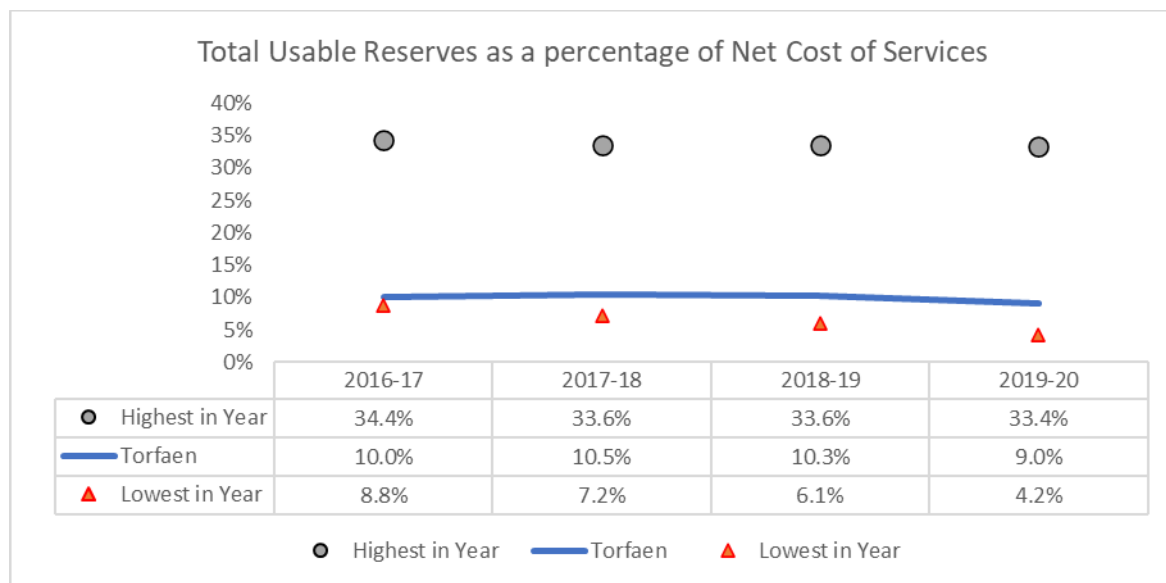
	2016-17	2017-18	2018-19	2019-20	2020-21
Net Cost of Services in £ millions ⁵	174.4	173.3	181.1	186.6	186.0
Total Usable Reserves in £ millions ⁶	17.4	18.2	18.7	16.7	25.4
Total Usable Reserves as a percentage of net cost of services	10	10.5	10.3	9.0	13.7
Comparison with the other councils of Wales	20-22	19-22	16-22	20-22	Not as yet available

⁵ Source: Statement of Accounts-Net Cost of Services (excluding housing revenue account figures) plus precepts, levies and debt interest

⁶ Source: Statement of Accounts

Exhibit 5: usable reserves as a percentage of net cost of services

This graph shows the Council's useable reserves as a percentage of net costs of services compared to the other Councils in Wales.



Overall, the Council's performance against budget remains strong and it is delivering a programme designed to address its children's services budget pressure

Why accurately forecasting expenditure is important

- 32 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

- 33 In our 2019-20 Financial Sustainability report we found that in recent years overspending in some service areas (Children's services and Neighbourhoods) had been offset by underspends in others, use of reserves and one-off windfalls.
- 34 In **Exhibit 2** we set out the funding provided by the Welsh Government through its hardship fund to cover the additional costs and lost income that councils have experienced due to the COVID pandemic during 2020-21. The Council received

additional Welsh Government funding beyond the hardship fund⁷, including, for example, funding for savings not achieved (£756,000), previous technology changes (£756,000) and costs of administering COVID business grants schemes for the Welsh Government (£309,000).

- 35 As a result of the pandemic, in 2020-21 actual spend against budgets in a number of areas, for example, staff travel, school transport and supplies, has reduced substantially, and the Council looked to hold vacancies whenever possible. Overall, the Council reported an underspend of £6.4 million against its budget at the end of 2020-21 as shown in **Exhibit 6** below.
- 36 In 2019-20, the Council saw a £2.8 million overspend on the children's placements budget and in 2020-21 that budget saw an overspend by £1.53 million against the increased budget for 2020-21.
- 37 In response to the ongoing budget pressure in children's social care, the Council started a Children's services transformation programme in April 2019. That programme includes an aim to strategically reduce the budget pressure faced in this area through a combination of actions and over a number of years.

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 also the provisional outturn position prior to external audit as reported to Cabinet in May 2021.

	2016-17	2017-18	2018-19	2019-20	2020-21 ⁸
Original net revenue budget £ millions ⁹	166.8	168.2	173.0	177.0	186.9
Actual net revenue outturn £ millions ¹⁰	165.8	168.2	170.8	176.9	180.6
Amount of overall surplus/overspend £ millions	1.0	0.0	2.2	0.1	6.3
Percentage difference from net revenue budget	0.6	0.0	1.3	0.0	3.4

⁷ Source: Cabinet report Financial Results 2020/21, 25 May 2021

⁸ Source: Cabinet report Financial Results 2020/21, 25 May 2021

⁹ Source: Statement of Accounts

¹⁰ Source: Statement of Accounts

To ensure continued financial resilience over the medium term the Council should consider how savings can contribute strategically to reducing its estimated funding gap

Why the ability to identify and deliver savings plans is important

- 38 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

- 39 In our 2019-20 Financial Sustainability report, we found that over the previous three years the Council had delivered nearly 80% of its planned savings, however, it had needed to develop alternative savings to cover the shortfall of £3 million.
- 40 Overall, the Council achieved 72% of its planned £1 million savings for 2020-21 (**Exhibit 7**). The achievement of some planned savings has been constrained by the impact of the COVID-19 pandemic.
- 41 Council officers recognise the key importance of delivering planned savings which are developed annually and then tested robustly before being proposed to members for scrutiny.
- 42 The Council's planned savings for 2021-22 amount to £2.6 million, however, Council officers told us that most of those savings do not reduce services nor directly impact on service delivery and are therefore low risk in terms of delivery.
- 43 During 2021-22, the Council has identified around £1 million of savings in children's social care by reducing growth in this service area. The savings are based on the successful implementation of planned activity under the Council's transformation programme for children's services, including the safe reduction of out-of-county residential placements. Council officers have confidence in the achievement of those savings.
- 44 Whilst we recognise that, due to the Welsh Government's annual budget settlements the Council develops savings on an annual basis, in light of its identified funding gap, the Council may now wish to consider the development of a medium-term approach to savings as part of its approach to strategically closing its funding gap.

Exhibit 7: savings delivered as a percentage of planned savings

The following exhibit sets out how much money the Council intended to save from its savings plans from 2017-18 to 2020-21.

	2017-18	2018-19	2019-20	2020-21 ¹¹
Total planned savings in £ millions ¹²	4.3	5.7	3.5	1.0
Planned savings achieved in £ millions ¹³	3.3	4.5	2.8	0.7
Planned savings not achieved in £ millions	1.0	1.2	0.7	0.3
Percentage of savings achieved	77%	79%	81%	72%

The Council's liquidity position has remained generally strong over the last five years

Why gauging current assets to current liabilities (liquidity) is important:

- 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.

What we found

- 45 At the end of 2019-20, the Council had a liquidity ratio of 1.2, which has declined from 1.4 in 2015-16. The trend analysis in **Exhibit 8** below shows that the ratio has always been greater than 1.

¹¹ Source: Cabinet report Financial Results 2020/21, 25 May 2021

¹² Source: Council's Budget reports

¹³ Source: Outturn reports

- 46 The Council regularly reviews its treasury management strategy and officers review the liquidity position daily. The Council's Governance and Audit Committee also receives regular treasury management monitoring reports.
- 47 In its most recent report to the Audit Committee in January 2021¹⁴, the Council estimated that borrowing levels were at about 90% of its approved limits.
- 48 The Council does not consider its liquidity ratio to be a significant risk and it has not experienced any liquidity issues. Its borrowing is below its capital financing requirement level and within its prudential borrowing limits.

Exhibit 8: working capital ratio 2015-16 to 2020-21 Source: Statement of accounts

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 (draft ¹⁵)
Current Assets ¹⁶	37.9	50.2	46.7	42.7	55.2	48.3
Current Liabilities ¹⁷	27.4	41	42.7	28.4	46.6	29.8
Working Capital Ratio	1.4	1.2	1.1	1.5	1.2	1.6

¹⁴ Treasury Management Strategy 2021/22 – 2025/26, Audit Committee 20 January 2021

¹⁵ Source: Unaudited 2020-21 statement of accounts

¹⁶ Current Assets includes: Short Term Investments; Assets held for sale; Inventories; Short Term Debtors; and Cash and equivalent.

¹⁷ Current Liabilities, includes Short Term Borrowing; Short Term Creditors; and Provisions due in one year.



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