

Financial Sustainability of Local Government

COVID-19 Impact, Recovery and Future Challenges

September 2021

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Councils have received significant extra funding to deal with the pandemic, but the future sustainability of the sector remains challenging against a backdrop of other financial pressures.

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Background

Our work on local government financial sustainability during 2020-21

Over 2020-21 we looked at the financial sustainability of each of the 22 councils in Wales, including:

- the financial impact of the pandemic;
- financial strategies;
- reserves position;
- performance against budget; and
- savings delivery and liquidity (the extent to which current assets are able to cover debt).

This report highlights some key themes and findings from our work, some commentary on funding pressures, and some reflections on how councils' future financial sustainability could be strengthened.



Main report

The bigger picture – borrowing, spending, and demand pressures

Extra short-term funding has helped but longer-term challenges and uncertainties remain

- The UK and Welsh Governments put in place major funding streams and grants in response to the pandemic – but these spending patterns are unlikely to be sustained.
- Our Picture of Public Services report published in September 2021 set out further information and analysis of public sector spending and future projections.
- Local government has a key role in supporting and shaping recovery from the pandemic, both as a provider of a wide range of key local services, and also through its community leadership role, including working with a range of partners.

Local government financial sustainability – how the situation in Wales compares with England

- England – the National Audit Office found that the financial position of local government remains a cause for concern with the outlook looking uncertain, and noted the reliance of many councils on using reserves to balance their 2020-21 budgets¹.
- Wales – councils have not generally relied on their reserves to balance their 2020-21 budgets, largely due to the additional funding made available to them to mitigate the impact of the pandemic. But significant future challenges remain.

1 National Audit Office, [Local government finance in the pandemic](#), March 2021

Exhibit 1: how councils’ usable financial reserves² had changed before the pandemic

All Wales total for unitary authorities, Total usable revenue reserves not protected by law

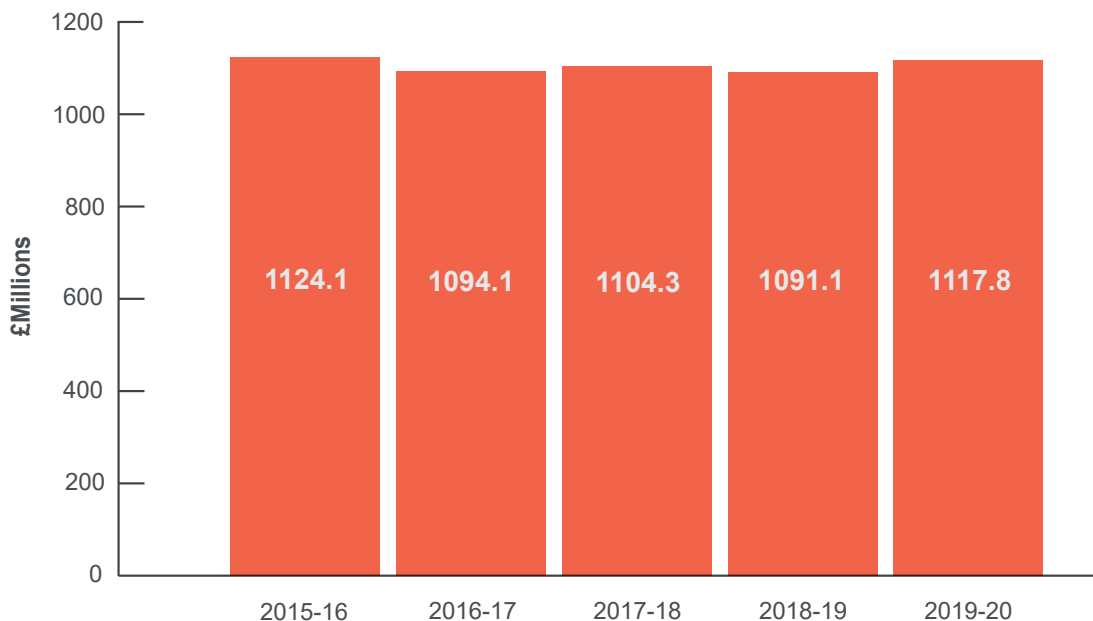
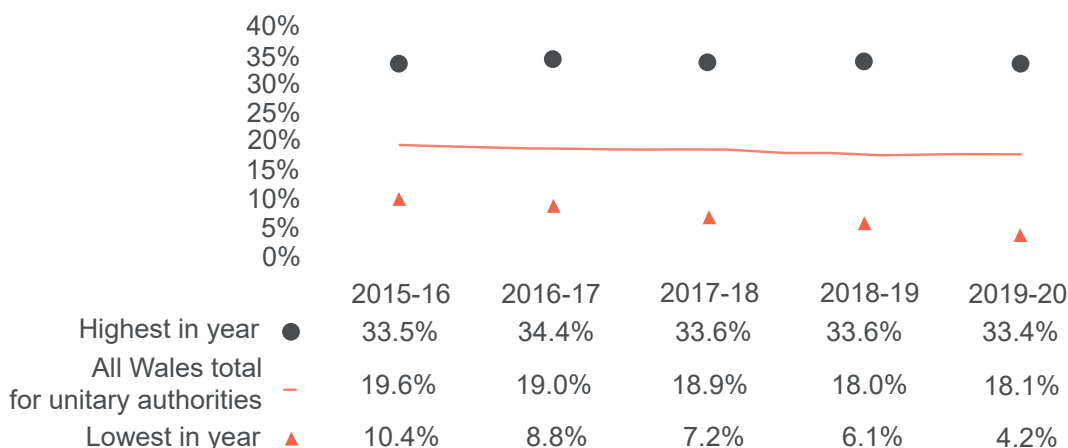


Exhibit 2: amount of usable reserves as a percentage of net cost of services over time

The following exhibit shows the average, highest and lowest values for the principal councils in Wales at the end of each financial year from 2015-16 to 2019-20.

Total Usable Reserves as a % of net cost of services



Lowest and highest refer to the value of an individual council in that particular year.

2 We define usable financial reserves as reserves usable for revenue costs, where the purpose is not protected by law. This is the total of the general fund, earmarked reserves and schools balances. It excludes Housing Revenue Account reserves, capital receipts and capital grants unapplied.

Public sector borrowing has increased during the pandemic and future funding levels are uncertain

- UK government borrowing has increased significantly during the pandemic³.
- Future funding levels remain uncertain, for example, in March 2021 Cardiff University described the outlook for the Welsh budget as ‘highly uncertain’⁴. The Chartered Institute of Public Finance & Accountancy (CIPFA) have also highlighted the uncertainty around public sector funding in the future.
- There is likely to be significant pressure on local government funding, in particular for those service areas that are not prioritised as part of future budget-setting⁵.

Demand for some services is likely to increase

- Our recent report on discretionary services⁶ highlights rising demand for some council services. The infographic on the following page, from that report, summaries some key demand pressures.
- Demand pressures from the pandemic will potentially continue, for example, for additional education provision to catch up on lost time during school closures. The longer-lasting implications of the pandemic on demand for local government services are as yet unknown.

Spending on discretionary local government services had already reduced before the pandemic

- Reductions in funding had already led to some service cuts before the pandemic⁷. Although the pandemic has raised the profile of local government services and in particular the role they play in helping to keep people safe and healthy.

3 CIPFA, [Local authorities face a financial reckoning](#), November 2020

4 Wales Fiscal Analysis, [Welsh Election 2021 Fiscal outlook and challenges for the next Welsh Government Welsh Election Briefing](#), April 2021

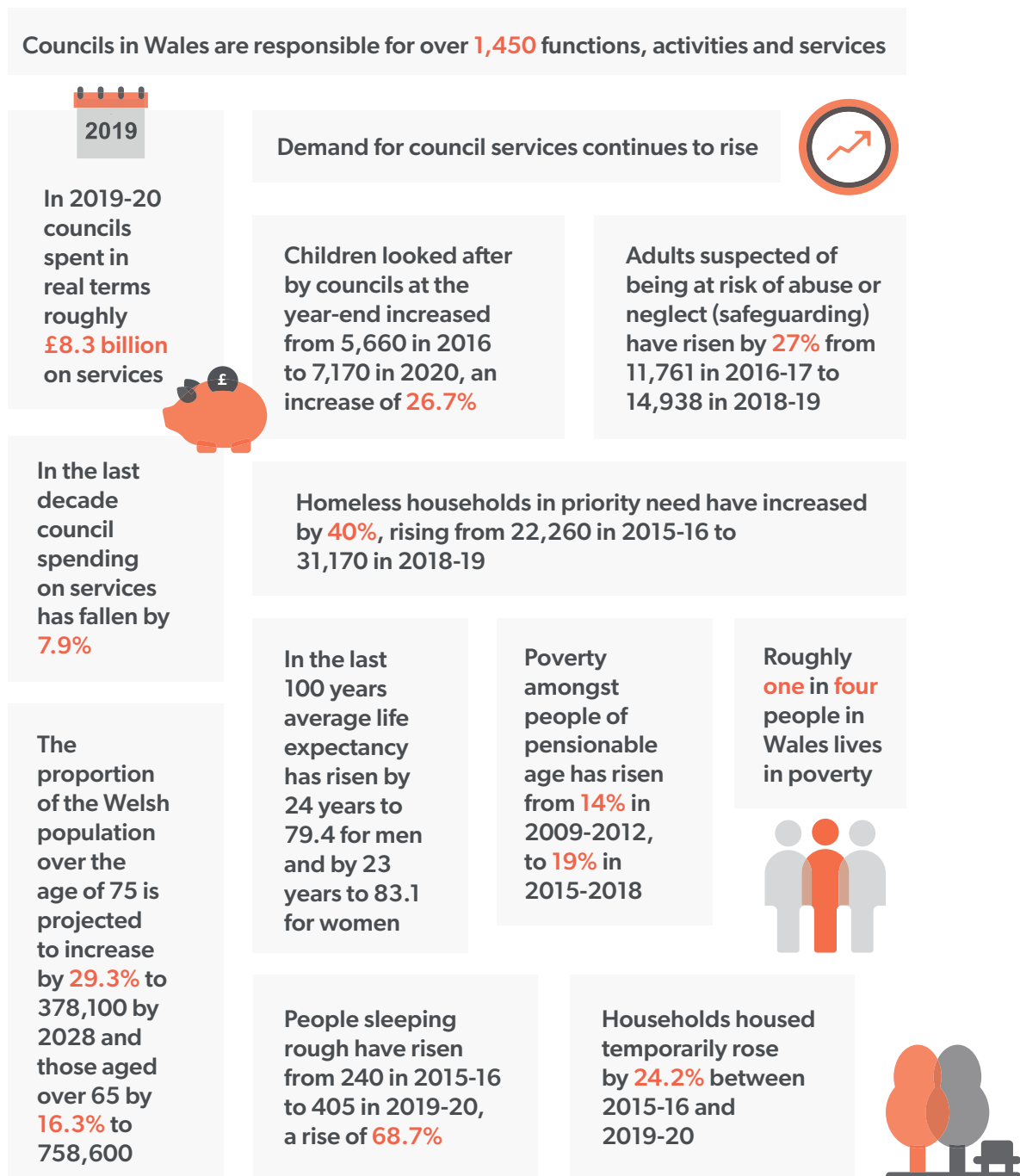
5 Wales Fiscal Analysis, [Local government finance: the state of play in 2021-22](#), March 2021

6 Audit Wales, [At your Discretion - Local Government Discretionary Services](#), April 2021

7 Audit Wales, [At your Discretion - Local Government Discretionary Services](#), April 2021

Exhibit 3: key facts about council services and demand⁸

The following exhibit shows some key facts about council services including some key demand pressures.



Note: The £8.3 billion figure for total council spending covers the total revenue spending on services and includes spending on some non-service areas such as repayment of borrowing, levies pensions and appropriations to reserves. The figure is net of income, such as charges and fees, generated by services. The gross expenditure on services in 2019-20 was £9.2 billion.

Financial sustainability – key findings from our work

Our findings from October 2020

- In October 2020, we said: ‘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.’ We also noted that ‘some Councils were better placed financially than others to deal with the financial challenges posed by the pandemic⁹.’

Overall findings from our work in 2020-21

- We found that Councils have received significant extra funding to deal with the pandemic, but the future sustainability of the local government sector remains challenging against a backdrop of other financial pressures.
- After publishing our national summary report in October 2020, we then looked at the financial sustainability of each principal council in Wales.
- We produced local reports for each council.
- Due to the extra funding councils have received in response to the pandemic, the financial position has improved for all 22 councils this year.
- But the overall picture of councils’ financial sustainability remains mixed, some councils are still better placed than others to respond to future challenges.
- The next section summaries the key themes we identified through this work, including where relevant from our October 2020 report as well as our previous work on financial sustainability.

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

Key themes from our 2020-21 work

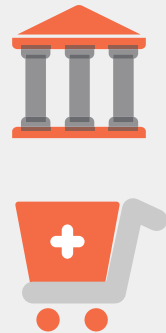
The financial impact of COVID-19

- We said in October 2020 that some councils were better placed financially than others to respond to the challenges of the pandemic.
- So far, the costs of COVID-19 have been mitigated at each council by extra funding from the Welsh Government.

Exhibit 4: The cost of COVID-19 over 2020-21

The following exhibit sets out the extra funding provided to councils by Welsh Government over 2020-21 in response to the COVID-19 pandemic.

- £660 million additional funding allocated by the Welsh Government to the Hardship Fund to cover councils' lost income and extra expenditure¹⁰.
- Other funding from the Welsh Government such as extra funding for teachers for catch-up support from education and cleaning materials for schools.
- Personal protective equipment (PPE) has also been provided free of charge to most local government bodies by the Welsh Government through NHS Shared Services.



Source: Welsh Government

Financial strategies

- Several councils have only undertaken limited analysis of the longer-term impact of COVID-19 (even in respect of working assumptions or scenarios) or the longer-term impact of changes to demand.
- Most, but not all councils include some council tax assumptions for the next four or five years in their financial strategies. These range from predicted increases of between 3% and 5%.
- Most, but not all, financial strategies also include Aggregate External Funding (AEF)¹¹ assumptions that vary between 0% and 3%. A few councils plan on the basis of best-to-worst-case scenarios.
- Overall, most of our local reports reflect on the ongoing work needed to develop a more sustainable approach to financial planning in the medium to long term.

¹⁰ Although the Welsh Government allocated £660 million, by the end of the financial year it reports having spent £587 million.

¹¹ Aggregate External Funding data includes Revenue Support Grant from the Welsh Government and Non-Domestic Rates.

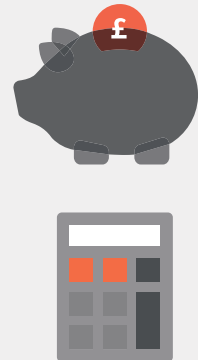
Reserves position

Exhibit 5: usable reserves – what we said in our October 2020 report¹²

The following exhibit summaries our key findings on councils' usable reserves¹³ position from our October 2020 report.

In October 2020 we reported:

- the usable reserves held by councils ranged from around £11 million to over £119 million.
- there was a wide range of usable reserves as a proportion of the net cost of services at each council: from 5% to 33%; and
- that Welsh councils in total held over £1 billion of usable reserves at the end of March 2020.



- Some councils have relatively high level of reserves that will support their ability to respond to challenges, and other councils have much lower levels of reserves, which will make meeting future challenges harder.
- After completing our local work we have also found that all councils increased the amount of reserves they held at the end of 2020-21. Councils have reported an increase of over £450 million in reserves during 2020-21. We will report further on this following our audit of 2020-21 accounts.
- Some councils have a good track record in recent years of avoiding using reserves to balance their budget.
- Some councils have relied on unplanned use of reserves to balance budgets. This approach is unlikely to be sustainable, particularly for those councils whose levels of usable reserves were already relatively low.
- A consistent pattern of using reserves, even in a planned way, to balance revenue expenditure is unlikely to be sustainable as it risks depleting reserves to unsustainable levels.

Performance against budget

- After large transfers to reserves, most councils reported either relatively small underspends or overspends overall in 2020-21, a similar pattern to the previous two financial years.

¹² Audit Wales, [Financial Sustainability of Local Government as a Result of the COVID-19 Pandemic, October 2020](#).

¹³ 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. This is the total of the general fund, earmarked reserves, and schools' balances. It excludes the HRA, Capital receipts and capital grants unapplied.

- Most councils also continued to show significant overspends in some service areas; in many councils, social services were an example of this.
- The pandemic, along with longer-term challenges, means that now more than ever, councils will need to manage budgets effectively and ensure that services or areas of consistent overspends are addressed.

Savings delivery

- Last year we found that most councils delivered the majority of their savings, but very few delivered all of their planned savings in previous years. We found the same pattern over 2020-21, as well as that some councils delivered all of their savings targets, although not as they had planned.
- Savings plans have understandably been affected by the pandemic. Changes in demand for services, workforce re-deployment and other action taken in response to the pandemic are all likely to have had an impact on the achievement of some savings.
- In a number of councils, service areas were still able to deliver their savings targets. Some service areas found it easier to deliver savings because of:
 - additional funding from the Welsh Government;
 - a reduced demand for services during the pandemic and/or;
 - reduced staff costs during the pandemic.
- Delivery of savings is likely to be even more challenging going forward given the scale of the projected funding gaps in some councils in future years, and that the above factors that helped some service areas to deliver savings over 2020-21 are unlikely to be recurring.
- Councils with robust and effective savings planning processes will be better placed to deliver on proposals and fulfil plans within the longer term.

Liquidity¹⁴


- Overall, most councils show a favourable and stable liquidity ratio (the ratio of current assets to its current liabilities) which suggests that those councils are in a good position to meet their current liabilities.
- A few councils show a relatively low liquidity ratio. In itself this is not a particular problem. But if levels of reserves are also relatively low and if savings are not being achieved, taken together this could indicate a lack of resilience.


¹⁴ Liquidity means the ratio of the council's assets to its liabilities

Four steps to help improve councils' financial sustainability

Exhibit 6: four steps to help with councils' financial sustainability

Based on the findings from our local work, together with the themes and challenges reflected on in this paper, the exhibit below summarises some key steps setting out what councils can do to improve financial sustainability.

1	<p>Financial strategies</p> 	<p>Understand short, medium and long-term challenges and clearly set out the overall priorities for the council's finances</p> <ul style="list-style-type: none"> • The Chartered Institute of Public Finance & Accountancy (CIPFA) highlights the uncertainty around public sector funding in the future, urging councils to use a range of data and forecasting work as part of their financial planning over the medium term¹⁵. • 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 anticipated funding pressures facing all councils, it is important to identify how to respond to those future pressures, and particularly how they will meet projected funding gaps. • Now is more important than ever to have a robust financial strategy that builds a picture of the council's financial situation over the medium to long term including well-evidenced projections around future demand pressures. • Councils should ensure that members are aware of, and understand, where their council's assumptions originate and where the assumptions sit in relation to those made by other councils. • The pandemic has also shown the benefits of building flexibility into financial strategies, and planning for different scenarios. Councillors should be presented with clear choices based on comprehensive and robust information including: <ul style="list-style-type: none"> - the total levels of reserves available to use; - future funding pressures; and - a full range of planning assumptions.
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2	<p>Reserves</p> 	<p>Plan your approach to, and use of, reserves to ensure that it supports longer-term financial sustainability</p> <ul style="list-style-type: none"> • Healthy levels of usable reserves are an important safety net to support financial sustainability. • As well as being available to meet 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 or for transformation programmes. • Regularly reviewing the levels of reserves and considering if levels are appropriate will help to set priorities around use of reserves. • Councils should ensure that councillors understand the role of both usable and unusable reserves, and how these link to the overall and longer-term financial strategy for the Council.
3	<p>Performance against budget</p> 	<p>Know what’s realistic for services to achieve and then understand and act on areas of consistent overspends</p> <ul style="list-style-type: none"> • 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. • Seek to manage budgets effectively throughout the year, as opposed to one-off budget exercises.

4

Savings delivery
Understand what is realistic for services to deliver on savings or cost reductions and act on areas that do not consistently deliver planned savings

- 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.
- Where savings plans are not delivered this can result in overspends that require the use of reserves whilst increasing the level of savings required in future years to compensate.
- 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.
- Now is more important than ever to get savings plans right, ensure that plans are realistic, and developed in collaboration between councillors, executive management teams and services.

Audit Wales future work on councils' financial sustainability

- For 2021-22, we will continue to monitor the financial position of individual councils through our ongoing audit work.
- Following completion of our audits of 2020-21 accounts we will also publish a financial sustainability data tool, including data on councils' year-end position for 2020-21, and continue to update this annually.
- We may undertake further work at some councils where we identify specific risks.
- We will return to national work in future where we believe the situation merits it and where we could add value.
- We will also consider the possibility of comparing the financial position of local government bodies in Wales with those across the UK as well as potential national work in relation to specific themes.
- In undertaking any potential future work, we will continue to engage with the Society of Welsh Treasurers.



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