



# Financial Sustainability Assessment – Caerphilly County Borough Council

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# Summary report

## 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 for 2019-20<sup>1</sup>, 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**<sup>2</sup>. 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 positions. 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 two 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 March and April 2021.

<sup>1</sup> Audit Wales, [Financial Sustainability Assessment, Caerphilly County Borough Council](#), March 2020

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

# Proposals for improvement

## Exhibit 1: proposals for improvement

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

<b>Proposals for improvement</b>	
<b>Proposal for improvement: strengthening the medium-term financial planning</b>	
P1	The Council should develop and implement a more comprehensive MTFP.
<b>Proposal for improvement: setting the annual revenue and capital budgets</b>	
P2	<p>The Council should examine the processes in place for its annual budget setting, and for its in-year budget revisions and outturn reporting.</p> <p>As part of the review, given the significant underspends that the Council has experienced in recent years, it should assess whether the process needs strengthening.</p> <p>The Council should then identify and implement any actions for improvement.</p>
<b>Proposal for improvement: to help address the funding gap identified in the MTFP, develop a programme of financial benefits from the Transformation Programme activities</b>	
P3	In further developing its Transformation Programme, the Council should ensure that the intended financial benefits arising are clearly defined and communicated. The Council should monitor its progress with achieving the intended benefits and regularly report the outcomes to elected members.

# Detailed report

The Council continues to have a strong financial position, although its current medium-term financial plan is underdeveloped

**The impact of COVID-19 on the Council's 2020-21 finances was largely assisted by additional Welsh Government funding, with similar additional funding currently extended to September 2021**

6 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

- To help mitigate the financial pressures of COVID-19, in July 2020 the Council established an earmarked reserve of £2.7 million to meet potential unfunded additional costs and lost income arising from the pandemic.
- In past years the Council had forecast and experienced a surplus against its budgeted council tax collections. However, due to the impact of COVID-19 and the Council's anticipated fall in the collection of council tax, it did not forecast a collection surplus for 2020-21.
- At the time of this review, although the Council had recognised that COVID-19 is likely to adversely affect its medium-term financial planning, it has determined that it was too early to identify and quantify the main financial impacts.
- In developing the 2021-22 budget the Council had recognised the risk of the Welsh Government's hardship fund not continuing into 2021-22. However, that risk was subsequently reduced by the Welsh Government's confirmation to all councils that it would be retaining the hardship fund for an additional six months, to 30 September 2021.
- **Exhibit 2** shows the level of additional expenditure and lost income that the Council has reported that it has faced because of COVID-19. The exhibit also shows the extent to which the Council's financial losses have been assisted by additional Welsh Government funding, through its local government hardship fund.

## Exhibit 2: the reported cost to the Council of COVID-19 over 2020-21<sup>3</sup>

The table below shows the Council's additional expenditure and lost income over 2020-21 because of COVID-19, and how much of this was mitigated by extra funding from the Welsh Government.

The additional amount the Council spent as a result of COVID-19 over 2020-21.	£26.3 million
The amount of income the Council lost as a result of COVID-19 over 2020-21.	£7.7 million
The amount of additional funding the Council received from the Welsh Government over 2020-21 to mitigate the impact of COVID-19.	£32.8 million
The cost to the Council of COVID-19 over 2020-21, taking account of the extra funding provided by the Welsh Government.	£1.2 million

## The Council's medium-term financial plan is underdeveloped

### Why strategic financial planning is important

- 7 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

- In March 2020 we reported that the Council's medium-term financial plan (MTFP) did not fully reflect its record of significant underspending nor fully reflect its transformation plans. We had also reported that for many years the Council had significantly underspent its revenue and capital budgets, which had contributed to its increasingly high level of usable reserves.

<sup>3</sup> The Council's unaudited management accounts.

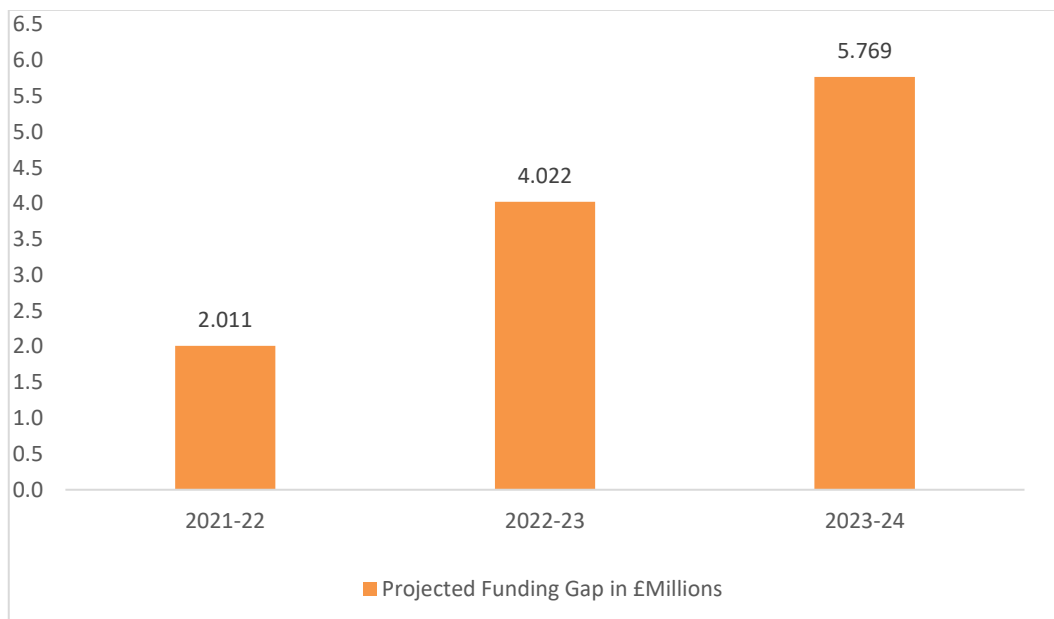
- For 2020-21 the Council is reporting further revenue and capital underspends.
- Last year we also reported that whilst the Council's 'Transformation Programme' had been published in June 2019, it contained only high-level links with the MTFP.
- At the time of last year's audit review, Council officers told us that the Transformation Programme would be developed further during 2020 and early 2021 to include more detailed and meaningful information within the Council's 2022-23 to 2025-26 MTFP.
- The Council has not made its planned improvements to this year's MTFP. We acknowledge and understand the Council's reason for not doing so, with the need to urgently tackle the impact of COVID-19 since March 2020.
- The Council's MTFP<sup>4</sup> published in February 2021 forecasts a £21.1 million funding gap, after taking account of a series of assumptions relating to income and expenditure for the four-year period 2022-23 to 2025-26. **Exhibit 3** shows the Council's reported funding gap for the three year period 2021-22 to 2023-24.

<sup>4</sup> Caerphilly County Borough Council, Indicative Medium-Term Financial Plan – 2022/23 to 2025/26, Council 24 February 2021



**Exhibit 3: the Council has a total projected funding gap for the three years 2021-22 to 2023-24 of £11.8 million<sup>5</sup>**

This graph shows the funding gap that the Council has reported for the three years to March 2024.



- 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 main underlying assumptions in the MTFP were reasonably consistent with other Welsh Councils.
- The current MTFP also assumes a tapered increase in non-pay inflation, rising to the Bank of England's target of 2% by 2025-26.
- While the Council's MTFP includes estimates such as those above, some other aspects remain underdeveloped. For example, the plan is brief and provides limited information around future demand pressures beyond schools and social services; does not reflect the ambitious transformation plans; and does not clearly identify potential risks to the Council's financial resilience in the coming years.
- The Council's MTFP does provide an overview of the sensitivity of the assumptions within its forecast to the end of 2025-26. For example, the

<sup>5</sup> Sources:

For 2021-22 Budget Proposals for 2020/21 and Medium Term Outlook, Council 20 February 2020

For years 2022-23 and 2032-24 Caerphilly County Borough Council, Indicative Medium-Term Financial Plan - 2022/23 to 2025/26, Council 24 February 2021

MTEP states that a 2% increase in Welsh Government funding per annum would reduce the four-year potential savings requirement to £9.2 million from £21.1 million. Conversely, the MTEP states that a 'cash flat' position would increase the potential savings requirement to £32.7 million.

- During the past year the Council has widened the scope of its Transformation Programme to reflect the changes brought about by COVID-19. The Programme now includes ten corporate reviews<sup>6</sup> which focus on fundamentally changing how the Council operates and delivers its services.
- At the time of our fieldwork, the Council recognised that while the initial stages of the Programme are now underway, its outcomes and benefits, including the financial benefits, are yet to be fully developed. The Council plans to develop them by Autumn 2021. The potential financial benefits arising from the Programme may contribute to the Council's aim to close its identified funding gap.

## The Council's usable reserves have increased further in the past year and remain at a high level

### Why sustainable management of reserves is important

- 8 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

- Last year we reported that the Council had an increasingly high level of usable reserves. Since then, over the past year the Council's usable reserves have increased further. **Exhibit 4** shows that as at 31 March 2020 the Council had usable reserves of £100.5 million, representing 25.3% of the its 2019-20 'net cost of services'. This percentage was the third highest for Welsh councils for 2019-20.
- In February 2021 the Council published its Place Shaping and Wellbeing Framework. This framework is the Council's capital strategy that sets out its intended capital investments. The Council has earmarked some £30 million

<sup>6</sup> Source: Strengthening Team Caerphilly, presented to the Council's Cabinet on 22 July 2020.

of its usable reserves for the investments that, with external finance, could potentially total £231 million from 2021-23 and potentially beyond.

- The Council's 2021-22 budget also makes strategic use of £0.368 million from a £1.8 million reserve, previously earmarked by the Council for delivery of the MTFP, to appoint four fixed-term project managers. Council officers told us that those appointments are critical to increasing the pace of delivery of its Transformation Programme and Place Shaping and Wellbeing Framework.

#### Exhibit 4: analysis of annual usable-reserves and net cost of services

This exhibit shows the amount of usable reserves the Council had for the four years up to 2019-20, as a proportion of its net cost of services.

	2016-17	2017-18	2018-19	2019-20
Net Cost of Services in £ millions <sup>7</sup>	362.7	388.9	421.3	397.6
Total Usable Reserves in £ millions <sup>8</sup>	82.4	87.0	90.9	100.5
Total Usable Reserves as a % of net cost of services	22.7	22.4	21.6	25.3
Comparison ranking across all Welsh councils <sup>9</sup>	5th	5th	5th	3rd

- The Council expects to report that its usable reserves will increase to £108 million at the end of 2020-21.

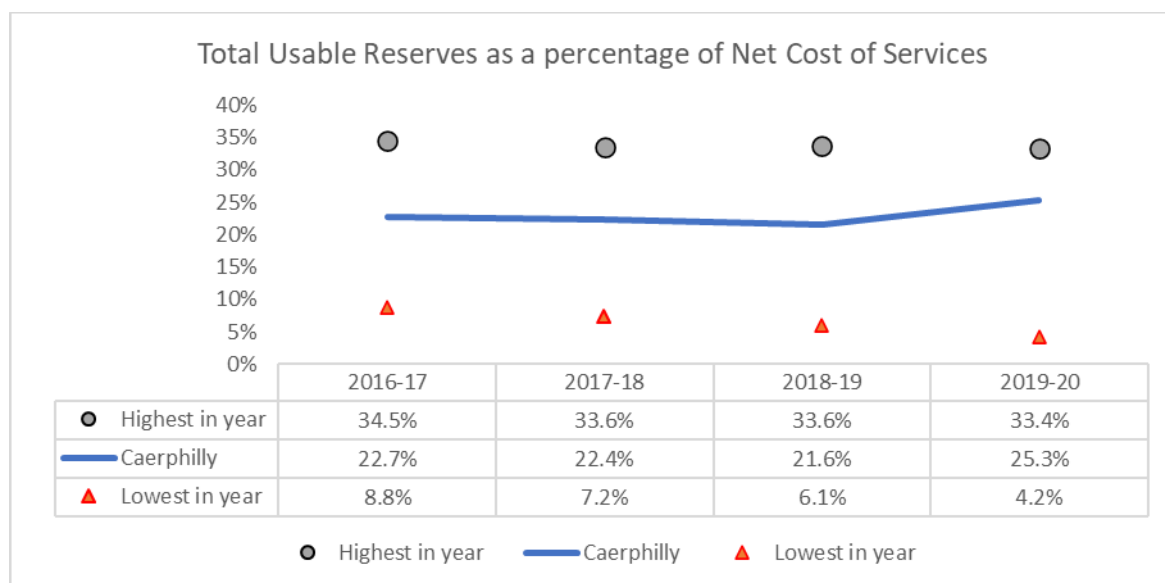
<sup>7</sup> Source: annual audited statement of accounts. The figures are based on the net cost of services, excluding the housing revenue account figures, and adding precepts, levies & debt interest.

<sup>8</sup> Source: annual audited statement of accounts.

<sup>9</sup> 1st being the highest percentage for Wales.

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

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



## The Council continues to underspend against its revenue and capital budgets

### Why accurately forecasting expenditure is important

- 9 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

- Last year we reported that the Council had significantly underspent both its revenue and capital budgets for many years, to 2019-20.
- Based on the Council's provisional outturn for 2020-21, the Council is reporting an underspend of £36.8 million against its 2020-21 revenue budget of £356 million, representing a 10.3% underspend<sup>10</sup>. Officers told us that a

<sup>10</sup> Source – provisional outturn to be reported to Cabinet on 7 July 2021.

proportion of this underspend results from additional Covid related grant funding.

- The Council's provisional capital outturn position for 2020-21 is an underspend of £28.8 million<sup>11</sup>.
- **Exhibit 6** shows that for the five financial years to 2020-21 the Council has underspent its revenue budgets by £79.8 million.

### **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 five years.

	2016-17	2017-18	2018-19	2019-20	2020-21 <sup>12</sup>
Original Net Revenue Budget £ millions <sup>13</sup>	324.4	325.4	332.0	337.7	356.1
Actual Net Revenue Outturn <sup>14</sup> £ millions	313.7	316.7	320.3	325.8	319.3
Amount of underspend £ millions	10.7	8.7	11.7	11.9	36.8
Percentage difference from net revenue budget	3.3	2.7	3.5	3.5	10.3

## **While the Council has a good track record of delivering its planned savings, it has no further planned savings within its current medium-term financial plan**

### **Why the ability to identify and deliver savings plans is important**

- 10 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 while 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

<sup>11</sup> Source: provisional capital outturn to be reported to Cabinet on 23 June 2021, excluding the Housing Revenue Account capital underspend of £9.3 million.

<sup>12</sup> Source – provisional outturn to be reported to the Cabinet on 23 June 2021.

<sup>13</sup> Source: the narrative report to the annual statement of accounts.

<sup>14</sup> Source: the narrative report to the annual statement of accounts.

being aligned to the Council's priorities, or of 'short-term' solutions that are not sustainable over the medium-term.

## What we found

- Last year we reported that the Council had delivered most of its planned savings in the previous two years and it expected to do so again for 2019-20.
- For 2019-20 the Council achieved £12.7 million (91%) of its planned savings of £13.9 million.
- For 2020-21 the Council's funding gap was £1.076 million, however, the Council agreed planned savings totalling £3.007 million which created savings in advance of £1.931 million. The Council also identified additional savings in advance during 2020-21 creating a total of £2.011 million of savings in advance.
- During 2020-21, the Council's achievement of its planned savings was considerably constrained by COVID-19. **Exhibit 7** shows that the Council expected to achieve £1.671 million (55.6%) of its £3.007 million planned savings. The shortfalls have not been problematic for the Council due to its ongoing budget underspends, and, if they had been necessary, its high level of usable reserves.
- The Council used the £2.011 million savings in advance from 2020-21 to help determine its 2021-22 budget, which therefore negated the need for any planned savings for 2021-22.
- The Council's current MTFP, however, does not include any planned savings to address the Council's reported funding gap of £11.8 million to the end of 2023-24.

## Exhibit 7: savings delivered as a percentage of planned savings

The following exhibit sets how much money the Council intended to save from its savings plans during 2017-18, 2018-19 and 2019-20 and how much of it actually saved, as well as its estimated figures for 2020-21.

	2017-18	2018-19	2019-20	2020-21 estimate <sup>15</sup>
Total planned savings in £ millions <sup>16</sup>	9	6.8	13.9	3.007
Planned savings achieved in £ millions <sup>17</sup>	8.95	6.4	12.7	1.671
Planned savings not achieved in £ millions	0.05	0.4	1.2	1.336
Percentage of savings achieved	98.5	94.3	91.4	55.6

## The Council has maintained a strong liquidity position for many years

### Why the Council's liquidity position is important

- 11 Why gauging current assets to current liabilities (liquidity, or the working capital ratio) is important:
- an indicator of how a council manages its short-term finances.
  - while it is commonly used to examine whether organisations can 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, however, act as an indicator of how a council manages its short-term finances.
  - councils with low liquidity ratios should ensure they have sound 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.

<sup>15</sup> Council estimate.

<sup>16</sup> Source: Statement of Accounts.

<sup>17</sup> Source: Statement of Accounts.

## What we found

- **Exhibit 8** provides analysis of the Council's liquidity since 2015-16. The analysis shows that the Council's liquidity is strong, with each financial year-end having a ratio of 1.5 or higher. A liquidity ratio above 1.0 means that a council has more current assets, at that point in time, than current liabilities.
- The analysis shows that for the three-year period to 31 March 2019, the liquidity ratio had decreased from 2.4 to 1.5. A key reason for the decrease is that, over those three years, the Council's short-term investments had decreased by some £31 million, alongside its long-term investments increasing by some £17 million.
- The Council forecasts its liquidity to remain strong at a ratio of 2.2 as at 31 March 2021.

### Exhibit 8: liquidity ratios for 2015-16 to 2020-21

The following exhibit shows the Council's level of current assets and liabilities as of 31 March in each year from 2016 to 2021 as well as its liquidity/ working capital ratio.

	31 March 2016	31 March 2017	31 March 2018	31 March 2019	31 March 2020	31 March 2021 <sup>18</sup> estimate
Current Assets £millions <sup>19</sup>	163	134.9	119.5	90.2	134.8	201.3
Current Liabilities <sup>20</sup>	67.4	68.4	71	61.4	87.6	89.9
Liquidity / Working Capital Ratio	2.4	2.0	1.7	1.5	1.5	2.2

<sup>18</sup> Unaudited balance sheet position as at 2 June 2021.

<sup>19</sup> Source: annual audited statement of accounts (except for 2020-21).

<sup>20</sup> Source: annual audited statement of accounts (except for 2020-21).







Audit Wales

24 Cathedral Road  
Cardiff CF11 9LJ

Tel: 029 2032 0500

Fax: 029 2032 0600

Textphone: 029 2032 0660

E-mail: [info@audit.wales](mailto:info@audit.wales)

Website: [www.audit.wales](http://www.audit.wales)

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