

# Financial Sustainability Assessment – Denbighshire County 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 in 2019-20, 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>1</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 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 April 2021.

<sup>1</sup> Audit Wales, [Financial Sustainability of Local Government as a Result of the COVID-19 Pandemic](#), October 2020.

## Recommendation

### Exhibit 1: recommendation

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

Recommendation
<b>Managing spend</b> R1 Ensure better alignment of budgets and operational activity to maintain ongoing financial sustainability.

# Detailed report

The Council is well placed to maintain its financial sustainability over the medium term – it has a good track record of managing its budget and continues to work to further improve its financial position

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

- 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.
- 7 We found that the Council has been claiming from the COVID Hardship fund to cover the financial impact of the pandemic.

### Exhibit 2: the cost to the Council of COVID-19 over 2020-21

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.	£9.4 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£12.2 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.	£20.9 million

The cost to the Council of COVID-19 over 2020-21 after extra funding from the Welsh Government is taken into account.	£0.7 million
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Additional funding from Welsh Government to cover 'savings not achieved' and 'digital transformation'.	£1.6 million
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Source – Council data to support the financial sustainability review

## The Council's financial planning arrangements are mature and further developing to maintain its financial sustainability over the medium-term

### Why strategic financial planning is important

- 8 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.
- 9 Public services have been significantly impacted by the pandemic and, in this context, mitigating the impact on councils will not only depend on the actions that they are able to take, but also to a large degree on the amount of resources allocated by governments. We recognise that a key issue for councils in trying to financially plan over the medium term remains uncertainty around both the level of funding they will receive from government, and their own income streams, such as council tax and fees and charges.

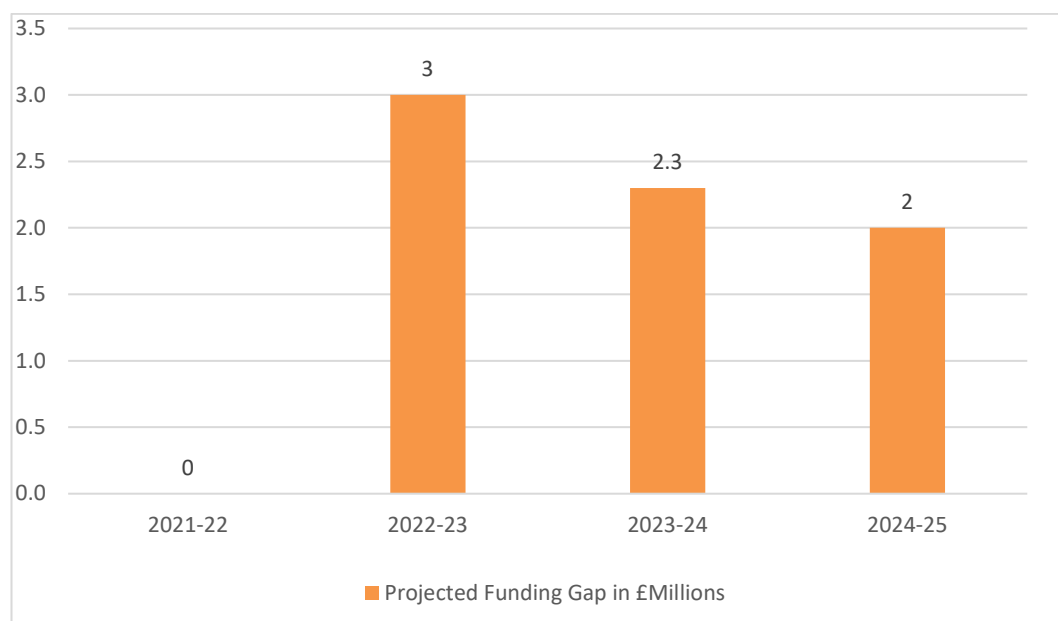
We found that:

- our 2019-20 Financial Sustainability report found that the Council's Medium Term Financial Plan (MTFP) did not set out how it would meet the then projected cumulative deficit of £14.4 million between 2020-21 and 2022-23.
- in this review we found that the Council had extended its financial planning to cover the period 2021-22 to 2023-24 when it approved the 2021-22 revenue budget in January 2021. At that stage it forecasts a funding gap of £2.6 million over the period.
- the Council has recently further updated its MTFP and has reported this to the Governance and Audit Committee in April 2021. The refined MTFP sets out revised assumptions including for 2024-25. This highlighted a funding gap of £5.3 million over the years 2021-22 to 2024-25. **Exhibit 3** shows the breakdown of the gap over the lifetime of the MTFP.

- the MTFP assumes no increase in Revenue Support Grant and Business Rates during 2022-23 and 2023-24. It sets out proposed Council Tax increases of 2.95% and 3.8% respectively for 2022-23 and 2023-24 and no use of reserves. The MTFP included increases for pay, inflation, Fire Service charges, Council Tax Reduction Scheme and schools demography adjustments. There was provision to cover increased service demand of £0.5 million in children’s services and £0.5 million to support delivery of priorities in both 2022-23 and 2023-24.
- the Council had taken a prudent approach to its financial planning which anticipated a future, dealing with the costs of the COVID-19 pandemic. A contingency of £683,000 was set aside in the 2021-22 revenue budget to cover the financial impact of COVID-19 and Brexit.
- the Council has continued to strategically plan its financial future for setting the 2022-23 budget which includes engagement throughout the 2021-22 financial year with the Budget Board, Cabinet, Savings Target Group, Trade Unions and ultimately full Council.

**Exhibit 3: the Council has a total projected funding gap for the four years 2021-22 to 2024-25 of £7.3 million**

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



Source: Updated Medium Term Financial Plan 2021-22 – 2024-25



## The Council's useable reserves have remained relatively stable since 2016-17 and are forecast to increase

### Why sustainable management of reserves is important

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

We found that:

- our 2019-20 Financial Sustainability report found that the Council uses its reserves strategically, retains healthy balances, and some important earmarked reserves are almost fully used as planned.
- **Exhibit 4** below shows that the Council has maintained a balance of useable reserves of between £36 million and £38 million over recent years. The total useable reserves as a percentage of net cost of services has reduced from 18.4 percent in 2015-16 to 15.5 percent in 2019-20. However, **Exhibit 5** shows that useable reserves as a percentage of net cost of services is in the lower half when compared to all other Welsh councils.
- whilst the Council held useable reserves of £36.4 million as at 31 March 2020, in practice some of these should only be used for specific purposes. Within the Council's earmarked reserves were school's balances of £1.4 million, a capital reserve of £9.8 million, an insurance reserve of £1.8 million and a modified loan reserve of £4.6 million.

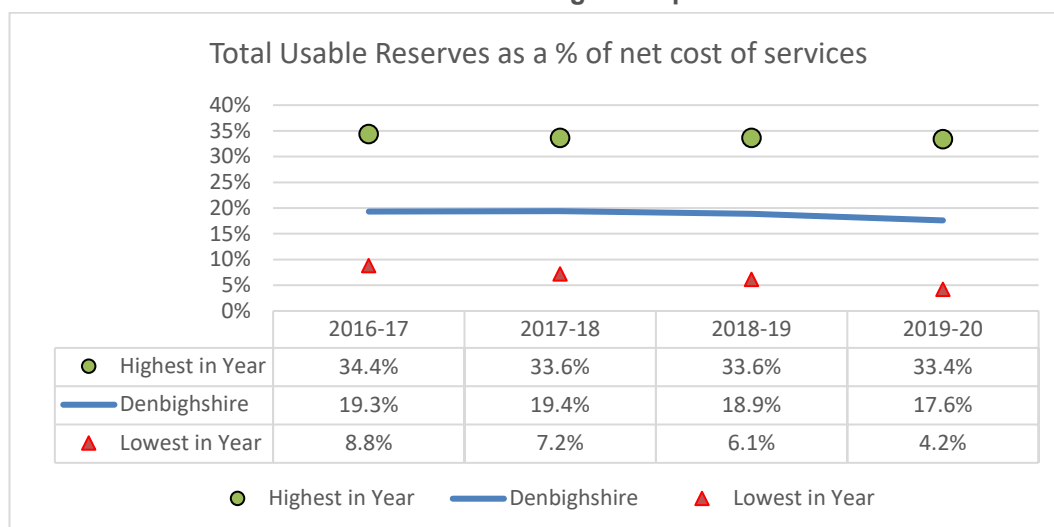
#### Exhibit 4: amount of reserves vs annual budget

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.

	2015-16	2016-17	2017-18	2018-19	2019-20
Net Cost of Services in £ millions <sup>2</sup>	196.5	190.6	190.7	200.9	207.4
Total Useable Reserves in £ millions <sup>3</sup>	40.6	36.8	37.0	38.0	36.4
Total Useable Reserves as a % of net cost of services <sup>4</sup>	20.6%	19.3%	19.4%	18.9%	17.6%
Comparison with the other councils of Wales	10th/22	10th/22	11th/22	10th/22	12th/22

Source – Statement of Accounts

#### Exhibit 5: amount of reserves vs annual budget comparison with other councils



Source – Statement of Accounts

### There continues to be some significant budget variations that the Council is working to resolve

<sup>2</sup> Value used is the net cost of services charged to the general fund from the Expenditure Funding Analysis, less any Housing Revenue Account cost of services, plus precepts, levies and debt interest. Source: Statement of Accounts.

<sup>3</sup> 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. Source: Statement of Accounts.

<sup>4</sup> Audit Wales calculation.

## Why accurately forecasting expenditure is important

- 11 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

- 12 Our 2019-20 Financial Sustainability report we found that although the Council underspent its overall revenue budget in 2017-18 and 2018-19, significant service overspends were offset by underspends in other areas. The 2019-20 revenue budget was forecast to overspend.
- 13 We found in this review that the Council has a track record of containing spending within 1% of its overall revenue budgets. **Exhibit 6** provides further details. In 2019-20, the Council overspent its service and corporate budgets overall by £0.19 million. Within this, and as with previous years, some services reported varying over and underspending. Education and Children's Services overspent by £1 million, Schools overspent by £1.3 million, Community Support Services overspent by £0.7 million and Planning and Public Protection overspent by £0.5 million. These overspends were offset by some service underspends such as in Corporate budgets of £2.7 million, Legal HR and Democratic Services of £0.2 million, Customer and Communication of £0.1 million and Business Improvement and Modernisation of £0.1 million.
- 14 The Council explained the reasons for budget variations in its 2019-20 Revenue Budget Outturn report. Prior to the pandemic, the Council held service challenge sessions to review performance. After a pause due to the pandemic in 2020-21, in 2021-22 the Council plans to resume these sessions with all services and the Head of Finance and Property plans to deliver a series of budget challenge sessions. This in year challenge and the budget planning arrangements referred to above have the potential to reduce the number of ongoing budget variations.
- 15 In recent years the Council has benefited from various forms of additional income or accounting adjustments that have offset service overspends. These include technical accounting adjustments and COVID Hardship payments to cover 'savings not achieved' and 'Digital Transformation' (not linked to actual spend or loss of income).

## 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 year to date as at March 2021.

	2016-17	2017-18	2018-19	2019-20	2020-21
Original Net revenue budget £ millions <sup>5</sup>	185.1	189.3	194.4	198.5	208.3
Actual Net Revenue Outturn £ millions <sup>6</sup>	185.1	188.1	192.9	198.8	205.6
Amount of overall surplus/(overspend) £ millions <sup>7</sup>	0.0	1.2	1.5	(0.3)	2.7
Percentage difference from net revenue budget	0.0%	0.6%	0.8%	-0.2%	1.3%

Source – Data provided by the Council as part of this review

## The Council has a track record of delivering most of its budget savings but not always as planned

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

16 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.

<sup>5</sup> Value used is the net cost of services charged to the general fund from the Expenditure Funding Analysis, less any Housing Revenue Account cost of services, plus precepts, levies and debt interest. Source: Statement of Accounts.

<sup>6</sup> 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. Source: Statement of Accounts.

<sup>7</sup> Audit Wales calculation.

## What we found

- 17 Our 2019-20 Financial Sustainability report found that the Council has a good track record of delivering planned savings although it is finding this more challenging as the balance shifts from making efficiencies to more impactful service change
- 18 In 2019-20 the Council agreed budget savings and efficiencies of £5.6 million. Of this, £0.5 million was corporate savings identified in 2018-19, £1.3 million was to be met by schools by reducing their funding by 2% and £3.9 million was from service efficiencies and savings, The Council achieved 89% of the service efficiencies and savings with £0.6 million funded through the Savings Achievement Contingency. Arguably, as schools overspent their budgets in 2019-20 by £1.3 million, this saving was not achieved.
- 19 In 2020-21 the Council approved service savings and efficiencies of £4.4 million. Of this £2 million related to the triennial actuarial review of the Clwyd Pension Fund, £0.7 million was delegated to the governing bodies of schools and £1.7 million was from service savings that had already been implemented.

### Exhibit 7: savings delivered during 2019-20 as a percentage of planned savings

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

	2018-19	2019-20	2020-21 estimate
Total planned savings in £ millions <sup>8</sup>	£4.6	£5.6	£4.4
Planned savings achieved in £ millions <sup>9</sup>	£4.6	£5.0	£4.4
Planned savings not achieved in £ millions	£0.0	£0.6	£0.0
Percentage of savings achieved	100%	89%	100%

Source - Data provided by the Council as part of this review

<sup>8</sup> Value used is the net cost of services charged to the general fund from the Expenditure Funding Analysis, less any Housing Revenue Account cost of services, plus precepts, levies and debt interest. Source: Statement of Accounts.

<sup>9</sup> 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. Source: Statement of Accounts.

## The Council has maintained a liquidity ratio of below 1 over the period from 2016-17 to 2019-20

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

- 20 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.
- 21 We found that:
- the Council has had a liquidity ratio of below one since 2016-17 indicating that its current assets are equal to current liabilities and the Council has been able to cover all of its short-term obligations.

### Exhibit 8: working capital ratio 2015-16 to 2019-20

	2015-16	2016-17	2017-18	2018-19	2019-20
Current Assets <sup>10</sup>	33.8m	26.5m	40.7m	42.1m	61.4m
Current Liabilities <sup>11</sup>	34.9m	38.1m	63.9m	64.2m	77.2m
Working Capital Ratio	1.0	0.7	0.6	0.7	0.8
Average working Capital Ratio across all Welsh councils	1.4	1.2	1.0	1.1	1.1

Source – Statement of Accounts

<sup>10</sup> Current Assets include: Short Term Investments; Assets held for sale; Inventories; Short Term Debtors; and Cash and equivalent

<sup>11</sup> Current Liabilities, includes Short Term Borrowing; Short Term Creditors; and Provisions due in one year.





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