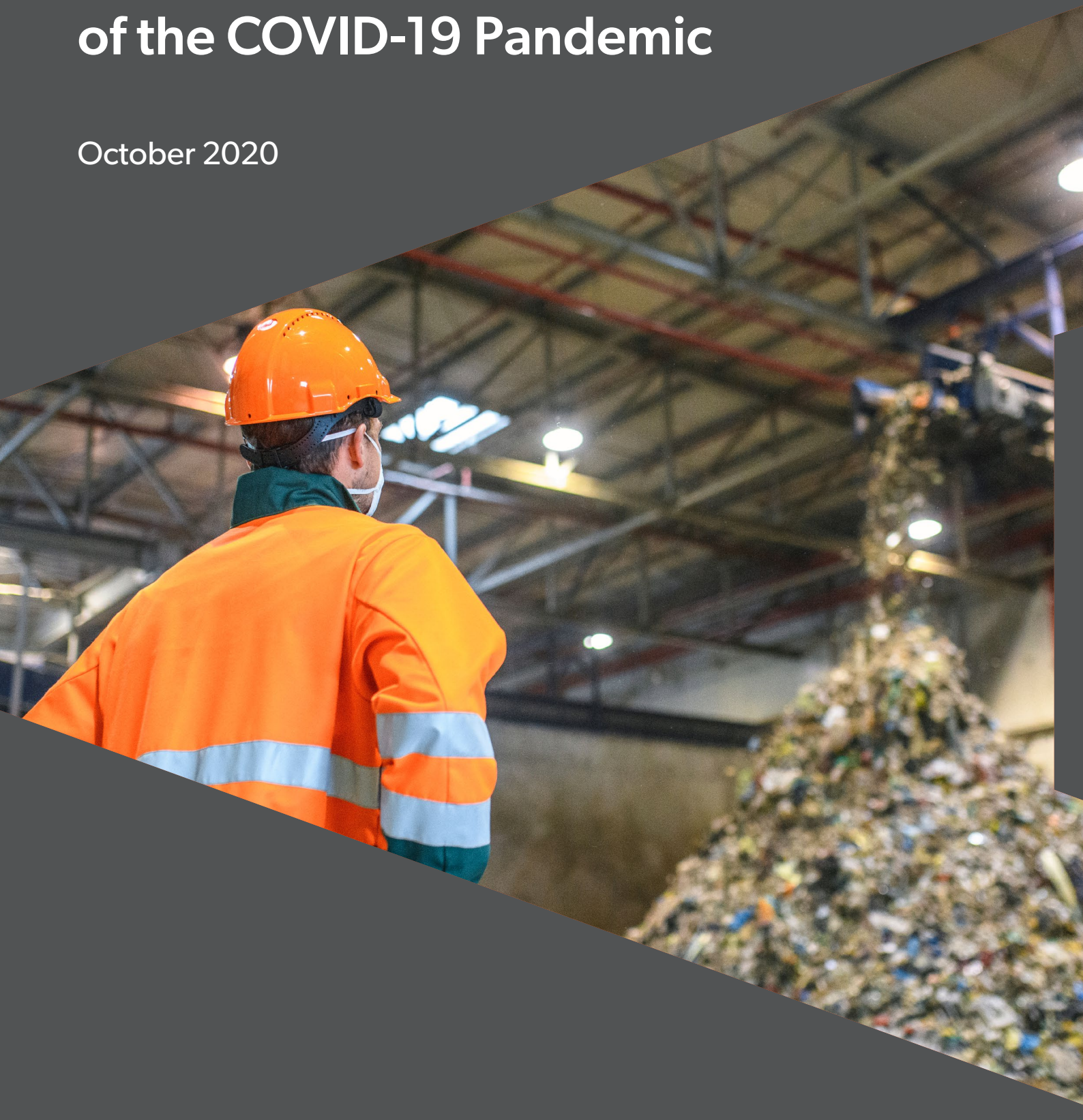


# Financial Sustainability of Local Government as a Result of the COVID-19 Pandemic

October 2020



Adrian Crompton  
Auditor General for Wales  
Audit Wales  
24 Cathedral Road  
Cardiff  
CF11 9LJ

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# Summary report

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## Summary

### Why we have produced this report

- 1 We had already identified financial sustainability as a key risk to councils' arrangements before the pandemic occurred. This was, in part, due to the significant pressures on UK and, therefore, Welsh public finances following the financial crisis of 2008-09. We produced a report on the financial sustainability of each local council during 2019-20, and these reports showed that councils were in very different positions in terms of their level of reserves and track record of spending within their agreed budgets.
- 2 Against this backdrop the pandemic has already had an even more profound and immediate effect on public sector finances as a whole and, as a consequence, on councils' financial position. The impact on public sector spending over such a short period of time is unprecedented in modern peace time.
- 3 This report is the beginning of our work looking at the financial sustainability of local councils during 2020-21, building on the work we completed in 2019-20. The report sets a high-level baseline position, including the reserves position, of local councils before the pandemic. It also sets out the initial financial implications of the pandemic for local councils and the scale of the anticipated challenge going forward, as well as some reflections on the preparedness of local government in Wales for such an unprecedented event. Finally, we set out how Audit Wales intends to provide support and constructive challenge to councils and the local government sector, as a whole, over the remainder of 2020-21, in their efforts to maintain financial sustainability against such significant funding pressures.

## Detailed report

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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

### **Against a backdrop of existing funding pressures, the financial costs of the pandemic are unprecedented in modern times**

- 4 Local government funding in Wales has been under significant pressure for over a decade, following the financial crisis in 2008-09 that triggered a severe worldwide recession.
- 5 In response to this, councils have relied on a combination of significant savings for example through efficiencies, transforming services and cuts to services to reduce costs. Councils have also increased their income through council tax and the fees and charges applied to some services. Our previous reports on the financial sustainability and resilience of local councils, including our work on savings planning in local government, includes more detail on this. These reports are [available on the Audit Wales website](#).
- 6 Against this backdrop, the cost to public spending of tackling the pandemic will seemingly dwarf the cost of the financial crisis, affecting health and wellbeing, the wider economy and public spending. Below are just some of the predictions that the Office for Budget Responsibility has made recently (July 2020):
  - net UK public sector borrowing to be between £264 billion and £391 billion for 2020-21;
  - UK GDP will shrink by between 10.6% and 14.3%; and
  - borrowing to fund public spending will rise to between 94.8% and 113.2% of GDP over 2020-21.

- 7 It is highly unlikely that the financial impact of the pandemic will be limited to the current financial year. It will almost certainly affect public sector finances including local government, for many years to come regardless of the future path of the pandemic. In an [earlier blog](#) in June 2020, we set out how £2.5 billion additional funding has been allocated to, and within, Wales in response to COVID-19. This illustrates the scale of the financial response to date. As with many things associated with the pandemic, things continue to change rapidly with further funding announcements from both the UK and Welsh Governments. ‘The Local Government Hardship Fund’ now makes available nearly £500 million in support including an announcement from the Welsh Government of up to £264 million in financial support for local authorities for the remainder of the financial year on 17 August 2020. Other funding available has also been made available for local authorities in addition to the hardship fund, for example in relation to extra funding for teachers for catch up support from education, cleaning materials for schools and part of the cultural fund.

### Some councils were better placed financially than others to respond to the challenges of the pandemic

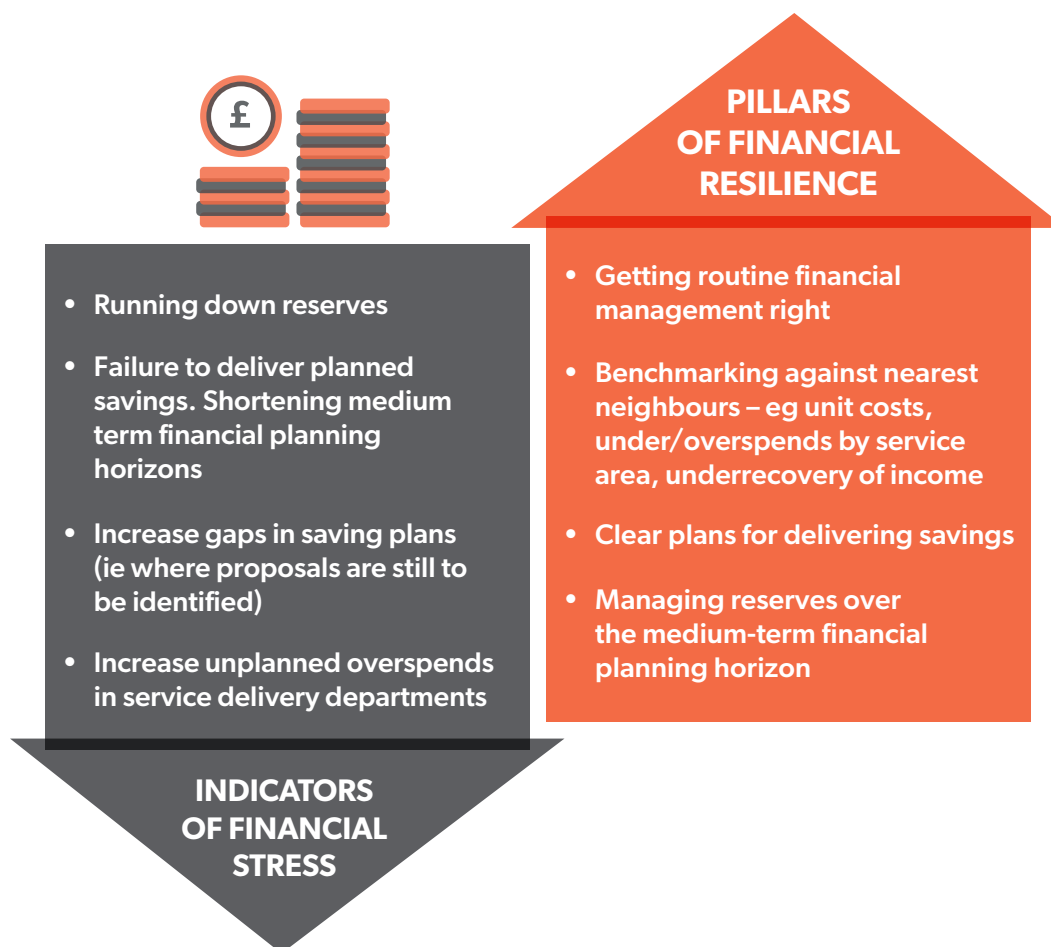
- 8 Over 2019-20 we looked at the financial sustainability of councils in Wales and produced a report on each council. Publication of some of these reports was delayed by the pandemic but most are [now available on our website](#).
- 9 The reports show that some councils were much better placed than others to weather a financial challenge such as the pandemic. This is most clearly illustrated by the varying levels of usable revenue reserves held by councils, their track record of spending within their agreed budgets in recent years and, linked to this, the extent to which their usable revenue reserves have been increasing or decreasing in recent years. We also think that the ability of councils to identify, plan and deliver savings is a key indicator of financial sustainability.
- 10 The report [Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting](#) by Sir Tony Redmond noted that:
- ‘This suggests that the external auditor should report to Full Council on risks identified and conclusions reached, in a transparent and understandable format. To be of most use, such a report would need to be timely.’<sup>1</sup>
- 11 The report also summarises CIPFA’s pillars of financial resilience and indicators of financial stress<sup>2</sup>. These are presented in **Exhibit 1** below and include several areas that we commented on in our work in 2019-20.

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1 Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting, Sir Tony Redmond, September 2020

2 building financial resilience: managing financial stress in local authorities, CIPFA, June 2017

### Exhibit 1: CIPFA Pillars of Financial Resilience<sup>3</sup>



- 12 **Exhibit 2** shows the level of usable revenue reserves held by each council at 31 March 2019 and then at 31 March 2020, together with the amount by which they increased or decreased over that time. **Exhibit 2** shows that, in total, councils held over £1 billion usable reserves at the end of March 2020. We commented above that for 2020-21 additional funding from the Welsh Government has largely mitigated the financial impact of the pandemic on local councils. However should the impact of the pandemic continue into future years, it may be the case that councils will need to increasingly use their reserves to meet additional costs or supplement income losses.
- 13 We would expect differences in the level of reserves held by each council with, for example, those councils with larger net cost of services are likely to hold higher levels of reserves. **Exhibit 3** shows the amount of reserves held by each council as a percentage of their net cost of services. This varies considerably between councils, with the usable reserves as a percentage of the net cost of services varying from 33% to 5%.

<sup>3</sup> Taken from the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting, Sir Tony Redmond, September 2020

- 14 However, the level of usable reserves should be treated with some caution. Whilst we have defined this as the level of revenue reserves including 'earmarked' reserves and 'general fund' reserves that could be re-purposed should the council decide to do so, we recognise in practise that some reserves would be easier to re-purpose than others, depending on what they have been earmarked for.
- 15 There are clearly a range of factors that could affect a council's financial sustainability as we noted above. These also include but are not limited to its balance sheet, level of liabilities and also other funding that it has available that could be re-directed such as contingency funds that are not part of reserves. Nevertheless, clearly a council with significantly higher levels of revenue reserves relative to its net cost of services that have been increasing in recent years, indicates that its financial position is more sustainable than a council with lower reserves that have been reducing over several years. Particularly where reserves have been used to fund unforeseen revenue expenditure.
- 16 The table below sets out the level of usable revenue reserves held by each local council at the end of 2018-19 and 2019-20. 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.

### What we mean by 'usable reserves'

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 the HRA, Capital receipts and capital grants unapplied.





**Exhibit 2: amount of usable reserves by local authority 2018-19 and 2019-20**

	<b>Net cost of services 2019-20 in £000<sup>4</sup></b>	<b>Usable revenue reserves at 31 March 2019 in £000<sup>5</sup></b>	<b>Usable revenue reserves at 31 March 2020 in £000<sup>6</sup></b>	<b>Increase/ (decrease) in usable revenue reserves between 2019 and 2020 in £000<sup>7</sup></b>
Blaenau Gwent	£148,762	£12,725	£14,056	£1,331
Bridgend	£289,242	£56,883	£64,562	£7,679
Caerphilly	£370,910	£90,896	£100,547	£9,651
Cardiff	£712,111	£67,969	£69,149	£1,180
Carmarthenshire	£373,888	£93,898	£100,837	£6,939
Ceredigion	£155,817	£24,192	£27,688	£3,496
Conwy	£237,279	£14,114	£11,005	(£3,109)
Denbighshire	£207,366	£38,047	£36,434	(£1,613)
Flintshire	£315,765	£27,334	£24,318	(£3,016)
Gwynedd	£250,149	£64,885	£71,090	£6,205
Isle of Anglesey	£143,705	£15,271	£16,017	£746
Merthyr Tydfil	£118,608	£16,743	£15,875	(£868)
Monmouthshire	£177,834	£13,741	£15,246	£1,505
Neath Port Talbot	£306,961	£61,394	£59,093	(£2,301)
Newport	£313,904	£94,742	£78,806	(£15,936)
Pembrokeshire	£240,375	£46,435	£45,746	(£689)
Powys	£276,153	£26,758	£28,584	£1,826
Rhondda Cynon Taf	£529,390	£119,470	£119,873	£403
Swansea	£444,555	£77,022	£93,752	£16,730
Torfaen	£186,602	£18,690	£16,738	(£1,952)
Vale of Glamorgan	£248,602	£81,161	£83,008	£1,847
Wrexham	£257,842	£28,944	£26,205	(£2,739)
<b>Total</b>	<b>£6,305,820</b>	<b>£1,091,314</b>	<b>£1,118,629</b>	<b>£27,315</b>

4 Draft statement of accounts for 2019-20 subject to audit. 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

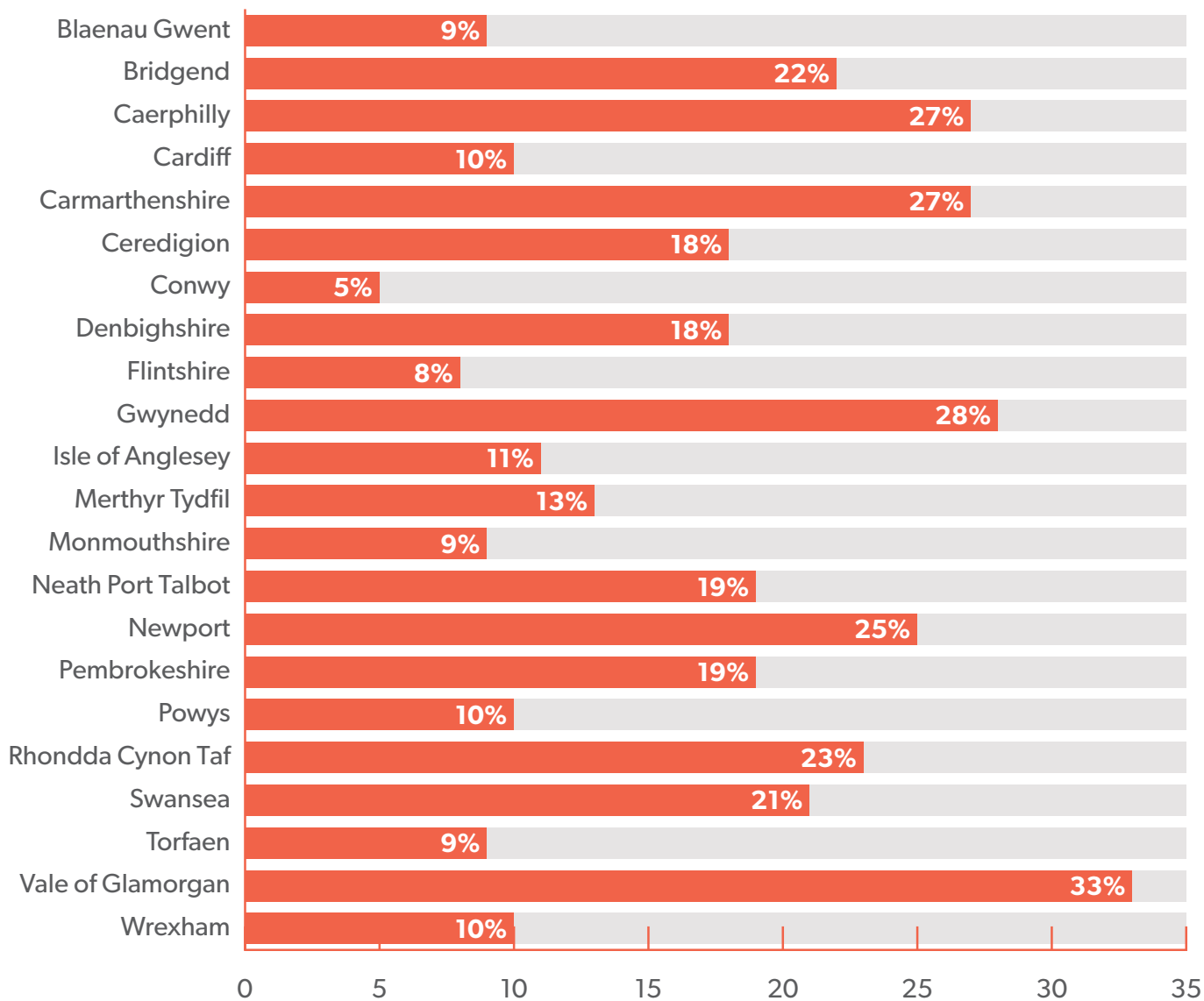
5 Audited Statement of Accounts for 2018-19

6 Draft Statement of Accounts for 2019-20 subject to audit

7 Audit Wales calculations

17 The exhibit below sets out the level of usable revenue reserves held by each local council at the end of 2019-20 as a proportion of the net cost of services of each council.

**Exhibit 3: amount of usable reserves as a proportion of the net cost of services of each council**



■ Usable revenue reserves as a % of net cost of services<sup>8</sup>

8 Usable reserves at 31 March 2020 as a proportion of net cost of services 2019-20

- 18 As shown above, at the end of the 2019-20 financial year councils held over £1 billion in usable revenue reserves, which equates to 18% of the total net cost of service across all councils. However, this is not evenly spread across councils, and it is also clear that some councils hold significantly more reserves than others relative to their approximate net cost of services. Although this is a relatively simplistic analysis, the level of usable reserves available to a council is one of the key indicators of financial resilience and sustainability.
- 19 From the work we undertook during 2019-20, that largely focused on the position at the end of the 2018-19 financial year, we identified some of the following themes that pre-date the pandemic but may well impact on the ability of councils to respond to it. These include:
- most councils reported either relatively small underspends or overspends overall in 2018-19 and it was a similar picture for 2017-18.
  - some councils relied on the unplanned use of reserves to balance their budgets during 2018-19. This approach is unlikely to be sustainable, particularly in those councils whose levels of usable reserves were already relatively low.
  - some councils relied on planned use of reserves as part of budget setting. Whilst this may have been planned at the start of the financial year, nevertheless, consistently using reserves, even in a planned way, to balance revenue expenditure is unlikely to be sustainable if this contributes to declining levels of reserves.
  - most councils, including those who delivered an overall surplus, still had some significant overspends in some demand-led services, with services such as social services being an area of overspend in many councils. Pressure on many demand-led services is likely to intensify as a result of the pandemic.
  - most councils delivered most of their savings, but very few delivered all of their planned savings in 2018-19.

## The cost of the pandemic to councils is significant, although a large proportion of the short-term impact has been mitigated through the provision of extra funding

- 20 The costs to councils in responding to the pandemic have been unprecedented both in their scale and the speed with which they have arisen. Additional funding has been made available to councils to mitigate these costs, however, the extent to which this will fully fund the cost of dealing with the pandemic, particularly over the medium to long term, is unknown. This is partly inevitable due to the rapidly developing picture in terms of the progress of the pandemic, as well as its economic impact. This picture will also change considerably depending on whether or not there are future waves of the pandemic, and how many and how severe they might be.
- 21 The pandemic has affected local government finances both in terms of increased costs and loss of income. **Exhibit 4** shows the estimated additional net expenditure and income loss that councils have estimated as a result of the pandemic for the first six months of the 2020-21 financial year for quarter 1 and quarter 2.
- 22 The biggest areas of increased cost pressures so far are in social services and education.
- 23 Councils receive income from a range of services including leisure facilities, car parking, school meals and school transport. The largest estimated income losses are in leisure and cultural services.
- 24 It is also clear that the financial impact of the pandemic is likely to continue throughout 2020-21 and into future years.
- 25 **Exhibit 4** sets out the total amount of additional expenditure and income loss that local authorities have estimated as a result of the COVID-19 pandemic, based on submission from local authorities to the Welsh Local Government Association (WLGA).

**Exhibit 4: total estimated additional net expenditure and income loss across the 22 unitary authorities in Wales as a result of the COVID-19 pandemic**

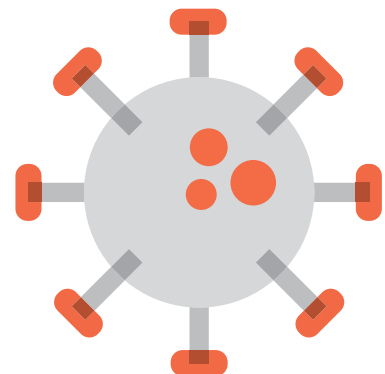
	Estimated additional net revenue expenditure	Estimated revenue income loss as a result of COVID-19
Quarter 1 (Apr-Jun)	£84.2 million	£100.1 million
Quarter 2 (Jul-Sept)	£81.3 million	£59.7 million

Source: WLGA

- 26 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. Added to this is the uncertainty around the potential future costs associated with the pandemic. We note above that Welsh Government made nearly £500 million available for councils through the Local Government Hardship Fund as well as other additional funding.
- 27 This has mitigated local councils additional costs and income losses to date, but depending on the future course of the pandemic, there may still be a significant funding shortfall for local authorities during 2020-21. Welsh Government has also accelerated access to the Revenue Support Grant and other funding streams early in the financial year to help councils' cashflow. Welsh Government also announced in August 2020 an extra £2.8 million for councils to help fund the increase in demand on the Welsh Government's Council Tax Reduction Scheme (CTRS) since the start of the pandemic. There is clearly uncertainty surrounding the future course of the pandemic and therefore the costs and income loss associated with it. This poses a considerable challenge to both local and national governments in supporting the sustainability of the local government sector. We recognise the many uncertainties around the course of the pandemic and the future funding that will be available to councils. This makes it more difficult for councils, and governments, to plan over the medium term. However to ensure the future sustainability of councils, robust medium term financial planning is crucial.
- 28 Our local work on financial sustainability will continue to examine the extent to which councils face a budget shortfall for this and future years, and their plans to mitigate this in the context of future Welsh Government funding.

## The financial challenges arising from the pandemic are numerous and go well beyond the more immediate and obvious costs of responding to the crisis

- 29 The pandemic is likely to affect almost every aspect of local government services, and therefore finances. The income loss and additional expenditure costs noted above are a significant element of this. But even as services re-open in the short to medium term, there will be added costs around the provision of personal protective equipment for staff and for other safety measures. For example, as schools re-open in September, there are likely to be costs associated with the re-introduction of school transport.
- 30 At the same time, it is likely that income streams such as from leisure centres and car parks will continue to be affected, due to safety requirements and/or potentially less demand for services. The economic impact of the pandemic is also likely to have wider repercussions for people's ability to pay for services, particularly those that they may view as 'non-essential'. This could also lead to an increase in eligibility for concessionary pricing schemes, which might also affect the level of income that councils are able to draw in.
- 31 As the economic impact of the pandemic deepens, it is also likely that income from council tax will fall, as well as housing revenue for those councils that still hold their own housing stock.
- 32 The sustainability of some services may be under threat with particular pressures likely to be felt in areas such as leisure services and the social care sector. The WLGA has also identified significant cost pressures in some service areas, most notably social services and education. By 2022-23 it estimates that the combined costs pressures in these services alone will equate to approximately £600 million.
- 33 Given the breadth, and depth, of the impact of the pandemic to date, alongside the uncertainty surrounding its future course, local authorities are likely to face difficult choices over the short and medium term. In this context, good strategic financial planning and robust governance and decision-making arrangements become even more important.



## **Audit Wales future work – supporting financial sustainability and recovering planning**

- 34 Over 2020-21, in keeping with our commitment to support public bodies' response to the pandemic, we will work with councils to gain assurance that they are putting in place proper arrangements to secure financial sustainability. In doing so, we will seek to gather and share real-time learning and practice across the public sector. The focus of our financial sustainability work over 2020-21 will be on the issues identified above and how councils are planning for a sustainable recovery over the medium and long term. This work will also run alongside our support and challenge of recovery planning and the work we are undertaking through our 'COVID-19 learning project'. We will shortly be engaging with councils to discuss the next phase of our financial sustainability work in more detail.



Audit Wales

24 Cathedral Road

Cardiff

CF11 9LJ

Tel: 029 2032 0500

Textphone: 029 2032 0660

We welcome telephone calls in  
Welsh and English.

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

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