

Financial Sustainability Assessment – Cardiff 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**¹. 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 February 2021 to June 2021.

¹ 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.

Proposals for improvement

Addressing the budget gap and savings planning

- P1 The Council needs to formulate and progress its plans to meet the medium-term budget gap, including:
- continuing to strengthen its savings planning process;
 - identifying the level of savings it can achieve through its transformation programme;
 - taking into account its other plans, for example about its estate, workforce and use of digital;
 - factoring in any medium to long term implications and opportunities from the pandemic; and
 - evaluating why savings have not been achieved in order to learn lessons and inform future plans.

Capital programme

- P2 The Council needs to ensure that its capital programme remains affordable in the medium to long term.

Pattern of overspending

- P3 Given the pattern of overspending in some key services, the Council needs to maintain its focus on understanding and addressing the reasons for these overspends to ensure they do not have a negative impact on its medium-term financial sustainability, particularly given its forecasted medium-term budget gap and increasing demand pressures.

Detailed report

The Council faces a number of key financial risks and has a significant medium-term budget gap but has arrangements in place to manage its financial sustainability

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:

- as shown in **Exhibit 2**, the Council's COVID-19 related expenditure and income losses are significant, but the majority has been covered by UK and Welsh Government funding. The pandemic has not, therefore, had a detrimental impact on the Council's short-term financial position to date.
- the Welsh Government's commitment to maintain financial support for councils for the first six months of 2021-22 provides the Council with some certainty about the anticipated level of funding it can expect to receive for the early part of 2021-22. However, because of the on-going nature of the pandemic, there continues to be a risk regarding the level of income and expenditure the Council anticipates receiving / incurring in the latter half of the financial year.
- the Council is taking a relatively prudent approach to its financial planning and is not assuming that the levels of Welsh Government and UK Government funding will continue to the same extent as they have over the past 12 months.
- the Council is starting to consider the longer-term implications and opportunities of the pandemic on its services and operating model.
- its medium-term financial plan (MTFP), agreed in March 2021, highlights some of the key Covid related risks both as a council and as a capital city. This includes risks relating to business failure and transport, as well as the potential behavioural shifts and the impact upon services. However, the Council acknowledges in its MTFP that it has not yet factored the financial impact of all these risks into its planning but will keep this under review.
- the Council produces a financial resilience snapshot to help it manage and monitor its financial resilience. The snapshot is considered regularly by

Cabinet and sets out the Council's position against a range of financial indicators and identifies the key risks to its financial sustainability.

Exhibit 2: the cost to the Council of COVID-19 over 2020-21 [2020-21 Outturn report to Cabinet, June 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.	£50.849 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£38.155 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.	£85.859 million
The cost to the Council of COVID-19 over 2020-21 after extra funding from the Welsh Government is taken into account.	£2.114 million

The Council continues to have a significant medium-term budget gap and the pandemic has affected its ability to consider how it will address this, but it is now starting to shape its plans to meet the gap

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.

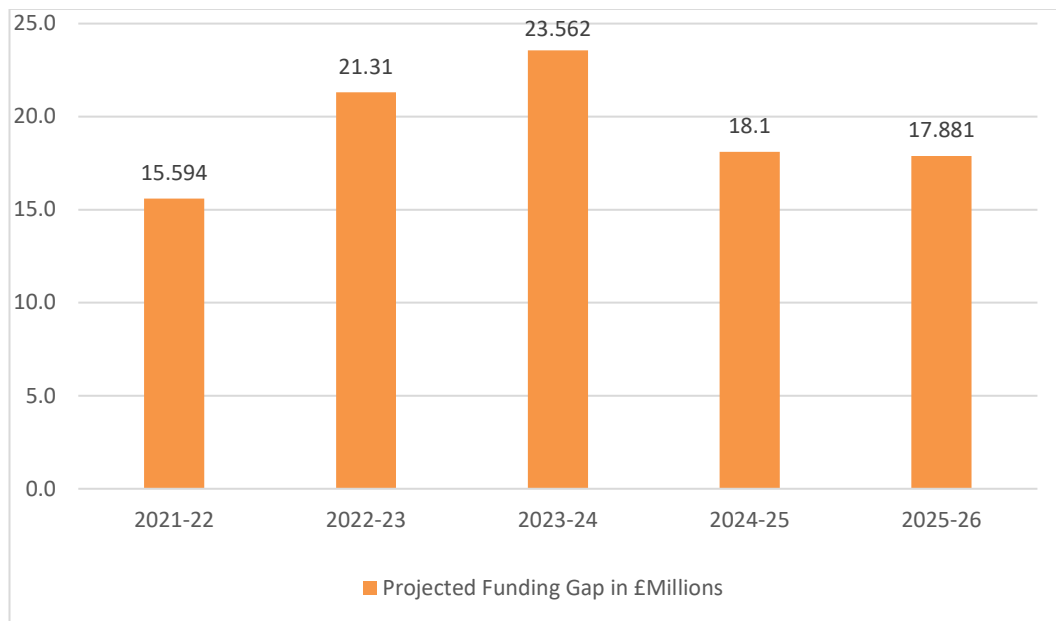
We found that:

- the Council has identified a budget gap of about £15.5 million for 2021-22, and a gap of just under £81 million for 2022-23 to 2025-26 so its financial outlook is very challenging.
- the Council's 2020-21 revenue outturn position was more positive primarily due to the receipt of a significant level of grant funding from Welsh Government at the end of the financial year. The Council has taken the opportunity to increase its earmarked reserves, which will help it reduce its budget gap over the medium term. However, as **Exhibit 3** shows, the scale of the gap over the medium term remains significant.
- the Council has already made over £200 million savings in the last 10 years.
- our 2019-20 Financial Sustainability report found that the Council had a medium-term financial plan based on reasonable assumptions but needed to consider how it was going to meet its longer-term funding gap, including strengthening the links between its transformation programme and its medium-term financial plan.
- our 2020-21 financial sustainability review has found that this largely remains the case as the impact of the pandemic has delayed its ability to consider the key actions it needs to take to address the projected medium term funding gap, but it is beginning to consider its plans.
- the Council has identified its significant financial pressures both over the short and medium term in its MTFP taking into account its strategic priorities, demographics, and demand pressures.
- the Council has considered a series of reports in May 2021 about its future operating model and services, ongoing efficiency programme, the recovery of the city, and climate change. These will provide the key framework for its next planned update to its MTFP in July 2021.
- the Council has set out that it intends to address its 2021-22 budget gap of £15.549 million through a combination of continued efficiency savings, income generation and an increase in Council Tax of 3.5%.

- the Council has started to consider its plans for 2022-23, but it recognises significant additional work is needed to set out more clearly how it intends to meet the budget gap over the course of the MTFP, including the level of savings it expects to achieve through transformation.
- whilst it recognises the difficulty in long term modelling, it is positive that the Council has set out in its MTFP its potential long-term financial outlook and budget modelling to 2035-36 based on an extrapolation of historic trends. In particular, it shows the potential budget reduction for services outside of education and social services, but it also flags that these other services include statutory services and that the Council will need to consider this in its financial planning.
- the Council has a very ambitious capital programme and it has estimated that its spend on its capital investment programme for the five-year period 2021-22 to 2025-26 will be almost £1.3 billion (£869 million general fund and £417 million public housing). Significant increases in capital financing costs are predicted as a result. Current forecasts are that the Council's capital finance costs expressed as a percentage of its controllable budget will rise from 16.4% in 2020-21 to over 23% in 2024-25 and 2025-26 and a capital financing gap of approximately £14.2 million in the period to 2025-26.
- the key assumptions in the Council's MTFP are relatively prudent. For example, these include that Welsh Government funding increases will be below that received in 2020-21 with funding anticipated to increase by 1% per annum from 2022-23 to 2025-26. The MTFP includes a sensitivity analysis explaining the impact should there be variation to some of the key assumptions in the MTFP.
- the Council has included a contingent liability for landfill tax in its financial statements since 2017-18. The Council has made some positive progress in addressing this with HMRC but until this process is finalised, the extent of any potential liability remains unknown and therefore could represent a potential risk to the Council's financial resilience. The Council provides us with regular updates on this and we will continue to monitor the position.

Exhibit 3: The Council has a total projected funding gap for the five years 2021-22 to 2025-26 of £96.447 million (Sources: Council’s 2021-22 budget strategy, February 2021, and budget strategy 2022/23 and updated medium term financial plan, July 2021)

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



The level of the Council's useable reserves had generally remained stable in recent years, but it has increased considerably in 2020-21

Why sustainable management of reserves is important

9 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 review at the Council found that the Council had not made any unplanned use of reserves to fund its revenue budget.
- as shown in **Exhibit 4**, the Council's level of useable reserves has remained relatively stable over the past four years, but it has increased its total useable reserves in 2020-21 by just over £47 million. This is primarily due to the receipt of some additional grant funding from Welsh Government at the end of the financial year
- the Council is planning to use £0.75 million from its strategic budget reserve to support the budget each year between 2021-22 and 2025-26 so it anticipates that its strategic budget reserve will reduce by £3.75 million over the next few years.
- the Council continues to have a range of reserves and contingency budgets, which provides it with options to support its financial resilience and manage on-going in year budget pressures. These include its:
 - Council Fund
 - looked after children contingency budget
 - general contingency budget
 - strategic budget reserve
 - financial resilience mechanism.
- more positive revenue support grant settlements in the past two years have meant that the Council hasn't had to use its financial resilience mechanism, which was set up to help the Council manage any funding uncertainty. The Council is not intending to use this in 2021-22 to deal with any financial uncertainty; instead, it is planning to use it to fund one-off investments.
- the Council acknowledges its levels of reserves are relatively low compared to other Welsh councils. However, currently, the Director of Resources and Cabinet Member for Finance, Modernisation and Performance are satisfied

that the levels of reserves are sufficient, but that the Council will take the opportunity to replenish its reserves at each year-end where it can.

- to date, the Council has used its reserves prudently to help manage its financial sustainability. It has maintained its Council fund reserves at about £14.25 million for the last three years and plans to keep it at this level unless it needs to use some in 2020-21 to offset overspends.

Exhibit 4: amount of reserves vs annual budget [Council’s Statement of accounts for 2016-17 – 2019-20, draft statement of accounts for 2020-21]

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 ²	657.1	667.4	692.4	712.1	646.6
Total Useable Reserves in £ millions ³	73.6	76.1	68	69.1	116.7
Total Useable Reserves as a % of net cost of services ⁴	11.2%	11.4%	9.8%	9.7%	18.1%
Comparison with the other councils of Wales	17/22	16/22	18/22	18/22	[2020-21 comparison not yet available]

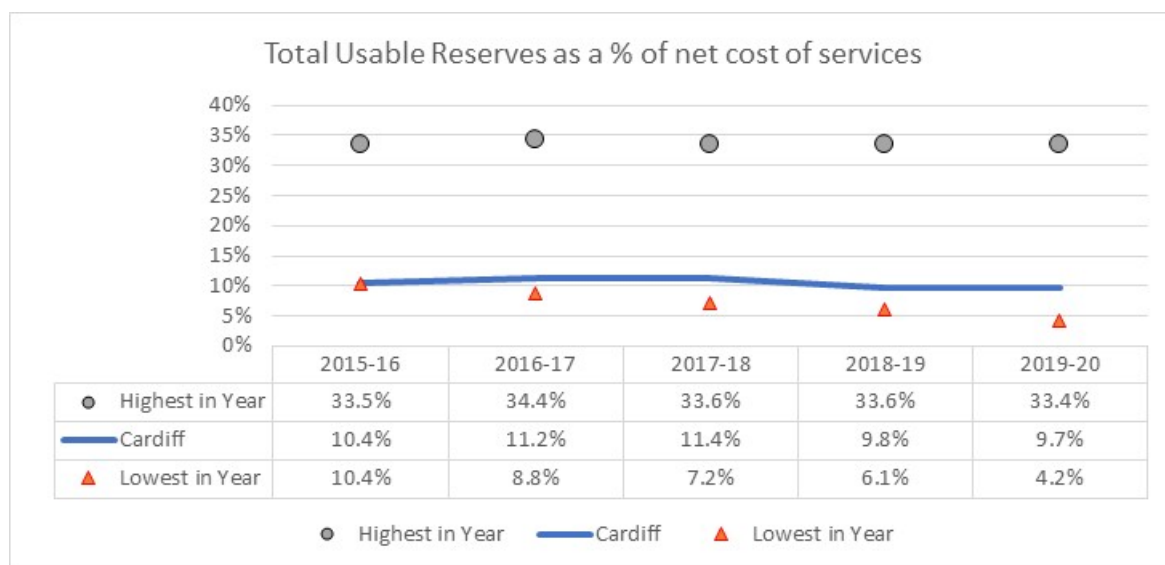
Exhibit 5: total useable reserves as a percentage of net cost of services (source: Audit Wales analysis)

² 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

³ 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

⁴ Audit Wales calculation.

The exhibit shows the total useable reserves the Council had from 2015-16 to 2019-20 as a percentage of net cost of services and relative to the to the highest and lowest of other Welsh councils.



The Council continues to manage its overall spend within budget, but further work is needed to manage overspends in some key services to help support its financial sustainability

Why accurately forecasting expenditure is important

- 10 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.
- 11 We found that:
- in our 2019-20 financial sustainability review at the Council, we found that the Council had managed its spend within budget, but there was a pattern of overspending in some service areas, such as social services and waste.
 - we found a similar position in 2020-21 despite the Council re-basing some of its budgets to take account of consistent overspends and reviewing the level of savings that these services could realistically achieve.

- the 2021-22 budget includes approximately £5 million of further budget realignments which take into account projected levels of demand to continue to help address some of the overspends.
- the Council's 2020-21 outturn report states that the Council has achieved a balanced position following transfers to and from earmarked reserves. Welsh Government provided significant additional grants at the year-end, which resulted in a number of directorates reporting improved positions and enabled the Council to increase its overall level of earmarked reserves. Consequently, the Council did not need to use its General Contingency budget.
- despite this, some Directorates were overspent at the year-end with the main overspends being in Social Services (£629,000), Governance and Legal services (£586,000) and Education and Lifelong Learning (£275,000).
- the Council is continuing to better understand the reasons for the overspends as well as increasing budgets over the course of the MTFP in response to forecasted demographic growth. The Council has some mechanisms in place, such as its general contingency and looked after children contingency budgets, to manage some of the risks to its financial sustainability.
- in social services, it is also continuing to focus on its preventative programmes to help manage the medium to long term demand pressures. However, given the continued level of overspends in some Directorates, the Council needs to ensure that Departments fully understand and are challenged on the reasons for continued overspends in these areas. We will continue to monitor the position over the course of 2021-22 to assess whether the Council's actions are having an impact.

Exhibit 6: amount of overspend/underspend relative to total net revenue budget
[Source: Council’s Statement of Accounts for 2016-17, 2017-18, 2018-19, 2019-20,
and draft statement of accounts for 2020-21]

The following exhibit shows the amount of overspend or underspend for the Council’s overall net revenue budget before any transfers to reserves for the last five years

	2016-17	2017-18	2018-19	2019-20	2020-21
Original Net revenue budget £ millions	578,161	586,984	608,913	623,589	656,186
Actual Net Revenue Outturn	570,996	584,532	617,042	622,409	608,576
Amount of overall (surplus)/overspend	(7,165)	(2,452)	8,129	(1,180)	(47,610)
Percentage difference from net revenue budget	1.2%	0.4%	1.3%	0.19%	7.3%

The Council has delivered significantly less savings than it planned, in part due to the pandemic, and it acknowledges the need to continue to strengthen its savings planning process, particularly given the scale of savings it needs to deliver over the medium term

Why the ability to identify and deliver savings plans is important

- 12 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.
- 13 We found that:
 - in our 2019-20 Financial Sustainability report, we found that the Council had a track record of achieving the majority of its overall savings, but it would become increasingly challenging to meet them in the future and the Council needed to strengthen its savings planning process.
 - as shown in **Exhibit 6**, the percentage of 2020-21 planned savings delivered by the Council reduced significantly to £4.477 million (ie 52%) of the planned target of £8.557 million. The Council identified that about £3.7 million of its planned 2020-21 income generation and service change related savings have not been achieved due to the pandemic. However, some of these have

been mitigated through the COVID-19 Hardship funding from Welsh Government.

- from 2016-17, the Council has achieved savings totalling approximately £56 million. This is a significant amount but is £26 million short of its required savings target of £82 million over the same period. The percentage of savings achieved in the last two years has also declined to 57% and 52% of its targets respectively.
- the Council's MTFP identifies that the Council needs to find £58.1 million of savings over 2022-23 to 2025-26.
- the Council informed us that it has strengthened aspects of its savings planning process with greater rigour and challenge of savings proposals. However, it acknowledges that the quality of business cases supporting savings still needs to improve and the more positive 2021-22 revenue grant settlement provides it with the opportunity to do this. It is vital that the Council continues to strengthen its savings planning arrangements if it is to achieve the level of savings required and prevent any unplanned additional savings being required from other Council services.
- as we reported last year, the Council also needs to determine the level of savings it is realistically likely to achieve from its transformation programme.
- both the Director of Corporate Resources and Cabinet Member for Resources indicated that discussions about savings for 2022-23 have already started and will inform the Council's Budget Strategy report in July 2021.
- we also consider that the Council would benefit from doing an annual lessons learnt exercise to help it understand why savings have not been achieved in order to learn lessons and inform future plans.

Exhibit 7: savings delivered as a percentage of planned savings [Sources: budget outturn reports.]

The following exhibit sets how much money the Council intended to save from its savings plans during 2016-17 to 2019-20 and how much of this it actually saved as well as estimated figures for 2020-21.

	2016-17	2017-18	2018-19	2019-20	2020-21
Total planned savings in £ millions	25.892m	14.157m	14.296m	19.157m	8.557m
Planned savings achieved in £ millions	19.417m	11.303m	10.207m	10.963m	4.08m
Planned savings not achieved in £ millions	6.475m	2.854m	4.089m	8.194m	4.477m
Percentage of savings achieved	75%	80%	71%	57%	52%

The Council's liquidity position is stable and supports its financial sustainability

Why the Council's liquidity position is important

- 14 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.

We found that:

- **Exhibit 8** provides analysis of the Council's liquidity position since 2015-16. The analysis shows that the Council's liquidity is strong, with each financial year-end generally having a ratio of 1.5 or above. A liquidity ratio above 1.0 highlights that the council has more current assets at that point in time, than current liabilities.
- the Council's current assets have increased primarily as a result of its short-term debtors having increased from £83.754 million to £193.5 million. Similarly, increases in the level of its short-term creditors and short-term borrowings (£154.1 and £35.4 million respectively as at 31 March 2021) has meant that its liquidity position has remained relatively stable.

Exhibit 8: working capital ratio 2015-16 to 2019-20 [Source: statement of accounts for each of the financial years 2015-16 to 2019-20 and 2020-21 draft statement of accounts]

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21 estimate
Current Assets ⁵	163m	170.9m	183.5m	190.1m	248.6m	333.5
Current Liabilities ⁶	115.3m	114m	111.5m	129.4m	154.7m	199.4
Working Capital Ratio	1.4	1.5	1.6	1.5	1.6	1.7

⁵ Current Assets, includes: Short Term Investments; Assets held for sale; Inventories; Short Term Debtors; and Cash and equivalent

⁶ Current Liabilities, includes Short Term Borrowing; Short Term Creditors; and Provisions due in one year.



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