Wolverhampton City Council **OPEN INFORMATION ITEM**

Audit Committee Date **24 September 2012**

Originating Service Group(s) **DELIVERY**

Contact Officer(s)/ Telephone Number(s) **PAT MAIN 4410**

Title **MEDIUM TERM FINANCIAL STRATEGY REVIEW – REPORT OF PRICEWATERHOUSECOOPERS**

SUMMARY

That the report prepared by PricewaterhouseCoopers be noted.

1. PURPOSE AND BACKGROUND

1.1 PricewaterhouseCoopers (PwC) as the Council's external auditors are required to assess the arrangements for securing economy, efficiency and effectiveness in the use of resources. As part of their work in this area they have undertaken a review of the Council's Medium Term Financial Strategy (MTFS). This focused on testing the assumptions that underpin the MTFS:

- inflation;
- spending reductions on savings;
- formula grant allocation;
- council tax, and;
- use of reserves.

1.2. They have taken into account the Council's recent track record of:

- setting realistic budgets;
- delivering services with budget;
- delivering planned savings targets;
- monitoring adequate levels of reserve balances.

1.3. PwC's conclusions are outlined in the attached report;

- the assumptions used in Wolverhampton's MTFS are broadly in line with other authorities;
- they have not identified any significant concerns;
- they have not identified any issues that would impact on their value for money conclusion.

2. FINANCIAL IMPLICATIONS

3.1 The report provides assurances on the arrangements the Council has in place to ensure effective stewardship and accountability for resources at a time of unprecedented financial pressures. [PM/10092012/O]

3. LEGAL IMPLICATIONS

4.1 Statutory authority for the external auditor role set out in paragraph 1.1 of this report which provides external accountability and control is currently contained in the Audit Commission Act 1998. [FD/13092012/L]

4. EQUAL OPPORTUNITIES IMPLICATIONS

5.1 There are not direct equal opportunities implications arising from this report.

5. ENVIRONMENTAL IMPLICATIONS

6.1 There are no direct environmental implications arising from this report.

6. SCHEDULE OF BACKGROUND PAPERS

None

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Wolverhampton City Council

Medium Term Financial Strategy Review

Mrs Pat Main
Section 151 Officer
Wolverhampton City Council
Civic Centre
St. Peter's Square
Wolverhampton
WV1 1SH

30 July 2012

Dear Pat

We are pleased to present our report on your Medium Term Financial Strategy, which benchmarks the key assumptions contained within your plans.

I do hope you find this report useful.

A number of our other clients have found their reports helpful– in understanding where they are in relation to others, challenging their own assumptions and managing members' expectations.

I would welcome a discussion with you as to how best we can report such information to members.

Please do not hesitate to contact me.

Yours faithfully

Richard Bacon

DRAFT

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Contents

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Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to directors or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any director or officer in their individual capacity or to any third party.

Introduction and Background

Audit responsibilities

Our Audit Code responsibilities requires us to carry out sufficient and relevant work in order to conclude on whether you have put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources.

In accordance with guidance issued by the Audit Commission, our work is focussed on the following two criteria:

- The Council has proper arrangements in place for securing financial resilience; and
- The Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The focus of these criteria for 2011/12 will be on whether:

- The Council has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future; and
- The Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

As part of our risk based audit work in this area we have therefore (as set out in our Audit Plan presented to the Audit Committee on 30 January 2012) undertaken a review of your Medium Term Financial Strategy (MTFS).

The scope of our work was focussed on reviewing the assumptions underpinning your MTFS.

Reviewing your Medium Term Financial Strategy

Key Assumptions

The Medium Term Financial Strategy (MTFS) is underpinned by a number of key assumptions. These include:

- Inflation – for both pay and non-pay expenditure;
- Growth – your estimate of future cost and budget pressures from changes in demand and volume;
- Spending reductions and Efficiency savings – the level and timing of the savings you need;
- Formula grant allocation – particularly for later years of the MTFS;
- Council Tax; and
- Use of reserves.

Each of these assumptions has varying degrees of inherent uncertainty. Assumptions applied to forecasts can often have a significant impact on balancing budgets. You have a recent history of delivering against budgets. However, the current economic climate is difficult and with so many assumptions being applied there is an increased risk that one of the influencing factors may vary significantly from the assumptions you have applied.

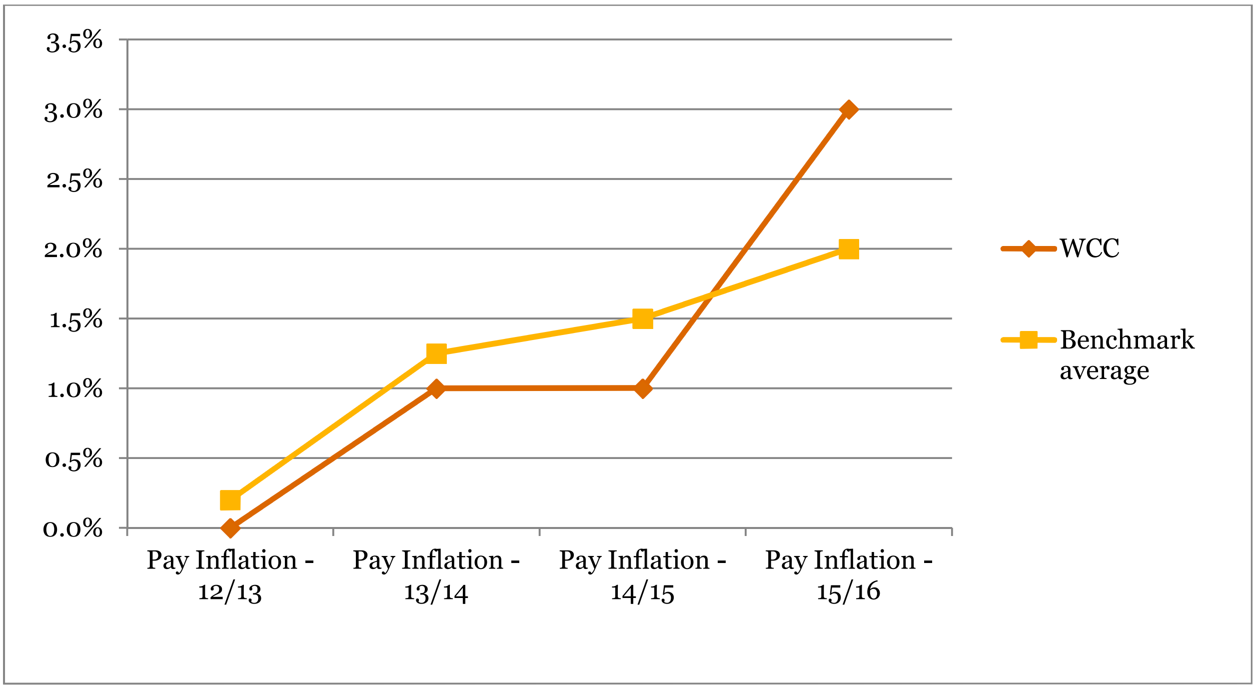
We have reviewed the assumptions in your MTFS and compared them to similar authorities in the Midlands. This exercise took place before the 2011/12 outturn was available so more recent information should now be available for some metrics. We have also taken into account our wider understanding of the sector. A summary of our findings is included below.

Inflation – pay costs

All of the Local Authorities in our benchmark group have assumed nil pay inflation for 2012/13. This is in line with the agreed local government pay settlement. You made the same assumption other than for individuals earning under £21,000 who you assumed would receive £250 in line with the June 2010 Emergency Budget. We have not included this amount in our analysis.

The assumption of pay varies across our benchmark group between 2013/14 and 2015/16 due to uncertainty about potential pay awards. You have assumed a similar level of pay inflation in 2013-2015 to our benchmark group but a slightly higher level of pay inflation in 2015/16. Your assumptions represent a reasonable estimate of likely future pay costs:

Graph 1: Pay Inflation



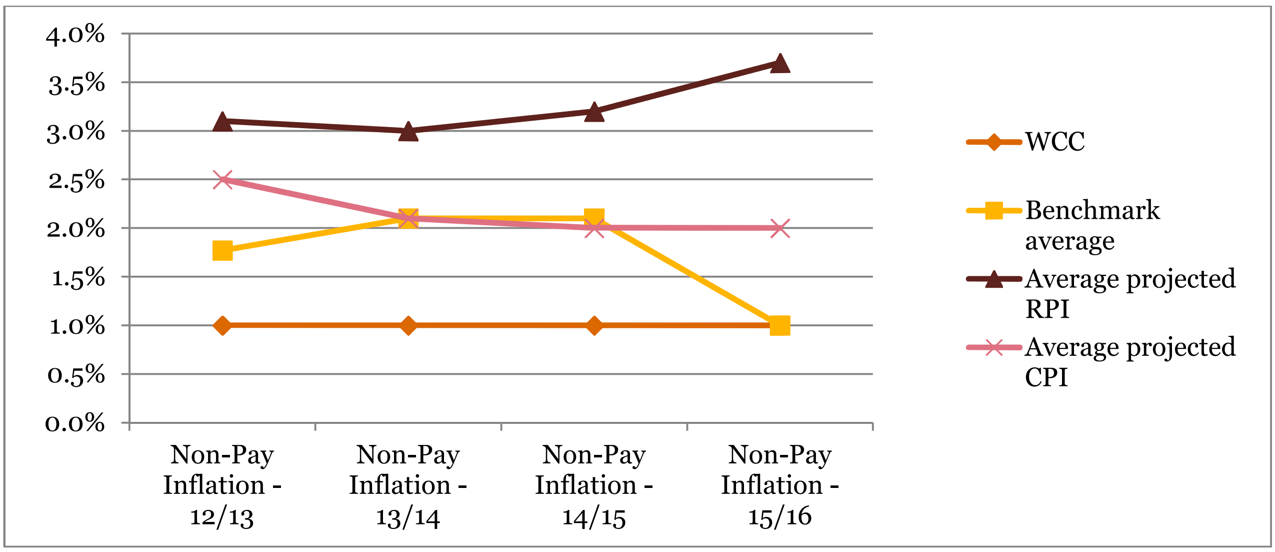
With pay costs representing a significant percentage of Wolverhampton City Council expenditure, this prudent assumption provides you with some ability to cope with pay costs rising above wider economic forecasts.

Inflation – non-pay costs

We were unable to calculate a reliable comparator between the Council and our benchmark group for non-pay costs. This was due to inconsistencies between the approaches taken by Council's for budgeting for inflationary pressures. You have not included an automatic inflationary increase of budgets by any standard index. Your budgets for gas, electricity and NNDR have all been increased by 4% a year from 2013/14. For all other items of non-pay expenditure we understand that you hold an unallocated sum equating to approximately 1% of controllable non-pay spend which gets allocated to specific budgets upon receipt of a reasonable bid for inflationary funding.

There is, therefore, no general inflation data for comparison purposes. For information only (and assuming 1% for Wolverhampton City Council), the following summarises non-pay inflation assumptions for the benchmark group alongside published RPI and CPI forecasts:

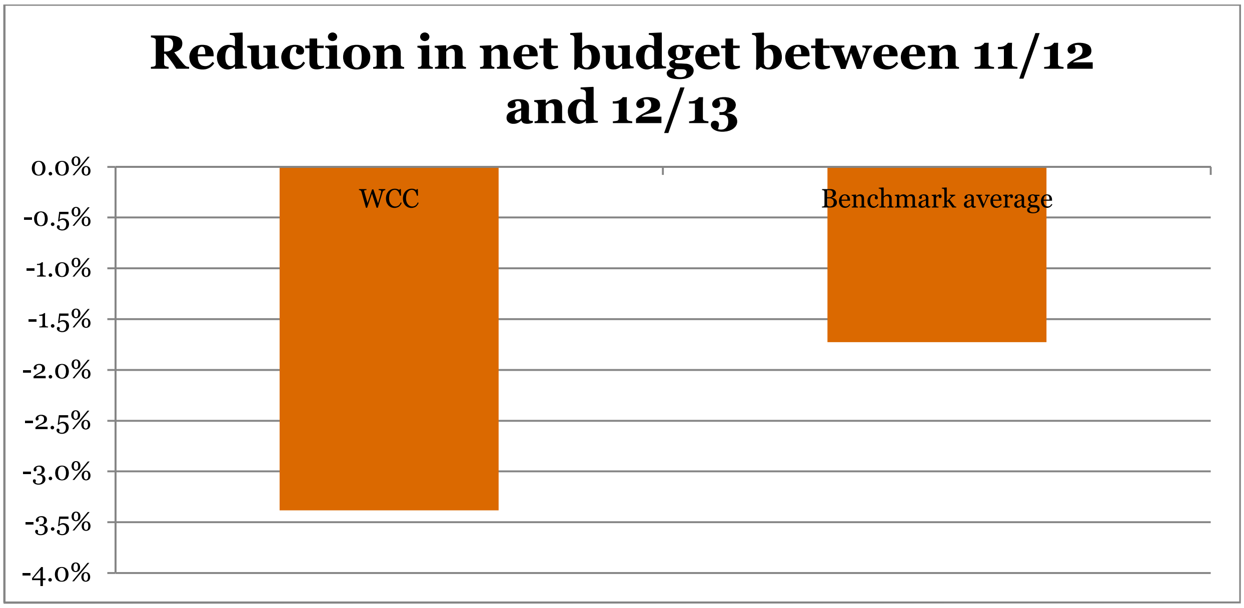
Graph 2: Non-Pay Inflation



Reduction in net budget

The level of budget reduction you need to deliver over the coming year is higher than the benchmark group:

Graph 3: Reduction in net budget as a percentage of 2011/12 net budget



This reflects the combination of growth pressures and savings plans analysed separately below.

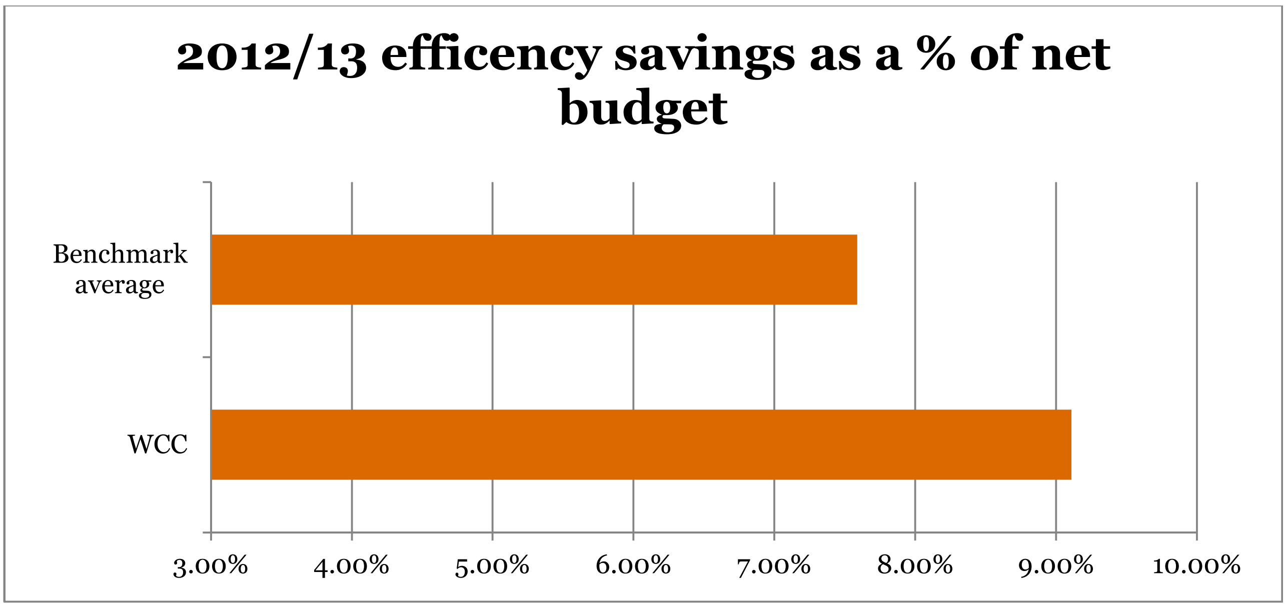
Growth pressures

We were unable to calculate a reliable comparator from our benchmark group for growth pressures. This was because of an inconsistent approach to this factor by Council's within our group, particularly for years beyond 2012/13. Based on the information we did have access to for 2012/13 we identified no concerns.

Efficiency Savings

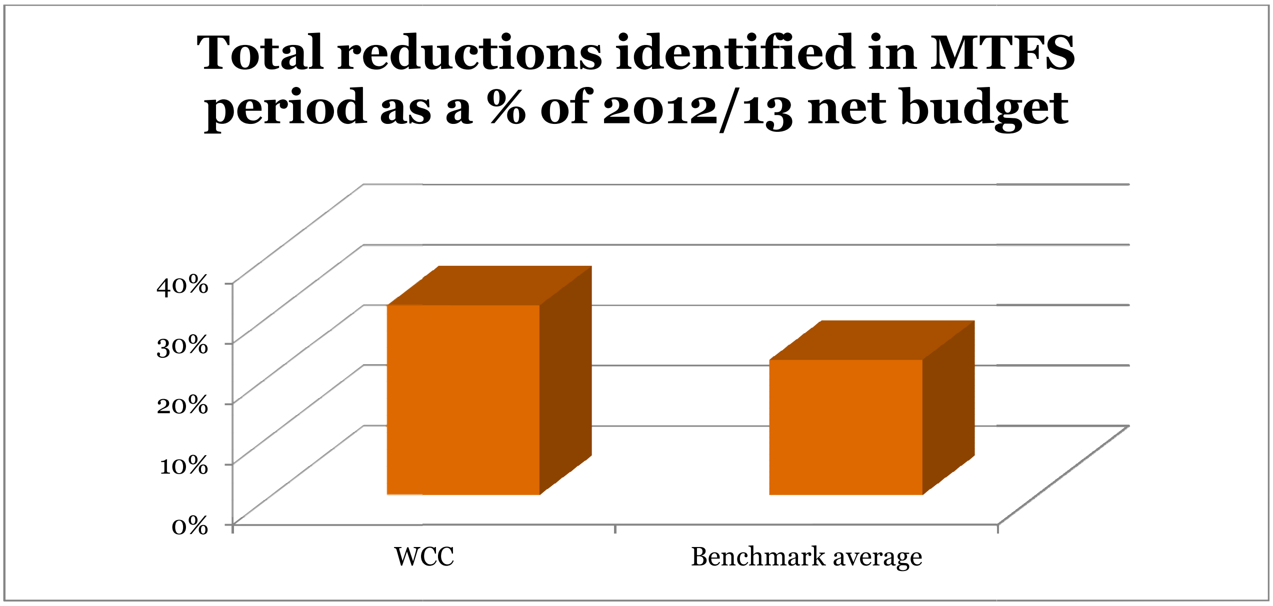
The level of savings you are planning to make in 2012/13 to deliver a balanced budget are slightly above those being made by the benchmark group as a percentage of their net budgets:

Graph 4: 2012/13 Efficiency Savings



In addition, the levels of savings you are making over the period of the MTFS are notably higher than for the benchmark group, with the most significant savings and the greatest pressures will come in the later years of the plan:

Graph 5: Total budget reductions over the MTFS



Cumulative deficit

Your latest MTFS includes the following levels of cumulative budget deficits:

	2012/13	2013/14	2014/15	2015/16	2016/17	Total
Cumulative budget deficit	0.0	3.0	9.4	17.2	23.0	52.7

We note that these deficits are subject to the successful delivery of the following 'new savings opportunities' that are subject to further analysis and validation:

	2012/13	2013/14	2014/15	2015/16	2016/17	Total
General Efficiencies (0.75% of expenditure budget)		-3.0	-3.0	-3.0	-2.0	**-11.0**
Shared Services Transition			-1.0	-2.4		**-3.4**
Terms and Conditions Review	-1.7					**-1.7**
Office Accommodation and Corporate Landlord			-0.5			**-0.5**
Procurement Savings	-4.1	-3.8	-4.5			**-12.4**
Total other savings to be explored	**-5.8**	**-6.8**	**-9.0**	**-5.4**	**-2.0**	**-29.0**

Failure to achieve these other savings at all could expose the Council to a £80m cumulative deficit should all else remain equal:

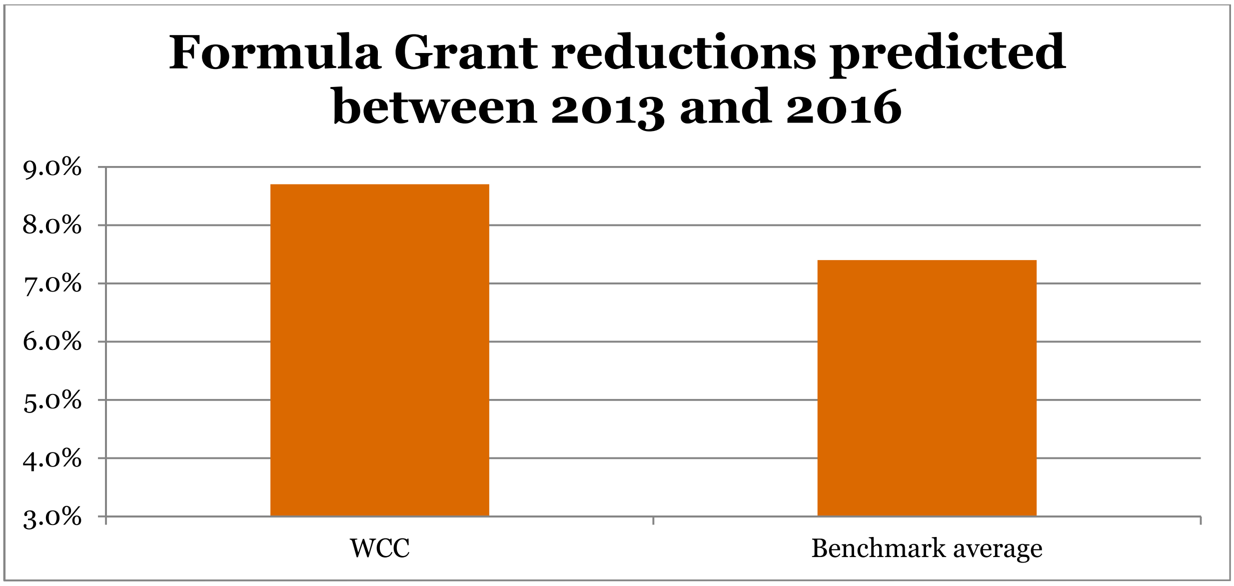
	2012/13	2013/14	2014/15	2015/16	2016/17	Total
Cumulative budget deficit	0.0	3.0	9.4	17.2	23.0	52.7
Total other savings to be explored	5.8	6.8	9.0	5.4	2.0	29.0
Total	**5.8**	**9.8**	**18.4**	**22.7**	**25.0**	**81.6**

Based on the above the successful delivery of planned savings, and the delivery of other savings as yet to be identified, is crucial to the ongoing financial standing of the Council. It is critical that savings plans, and the Council's arrangements to monitor these, are robust. Your levels of reserves do appear to be relatively healthy. Steps however must be taken to ensure that the financial gap highlighted within the above table is closed.

Funding

The level of revenue support grant (RSG) is known for 2012/13, but has not yet been disclosed for 2013/14 onwards. You have assumed a more significant continued reduction in RSG for later periods of the plan when compared with our benchmark group. Your assumptions appear to be prudent but not unreasonable. You will need to revisit your financial plans as and when further information about future funding decisions becomes available.

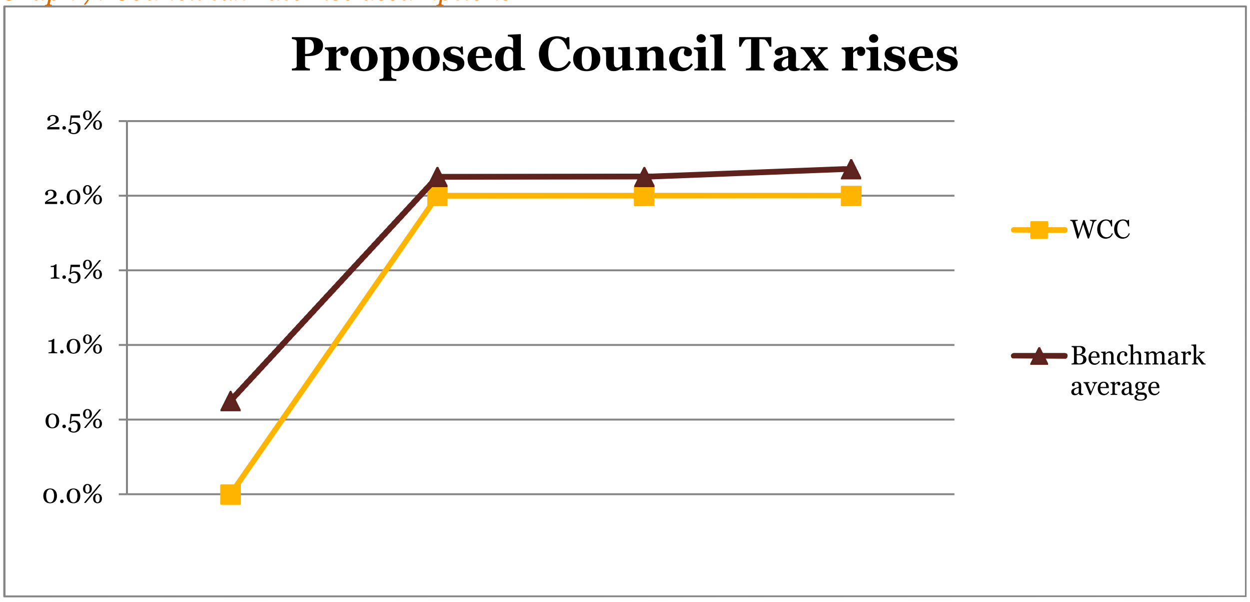
Graph 6: Formula Grant reductions



Council Tax

You have assumed a 0% increase in Council tax for 2012/13 but 2% increases per year thereafter. This approach was consistent with our benchmark group.

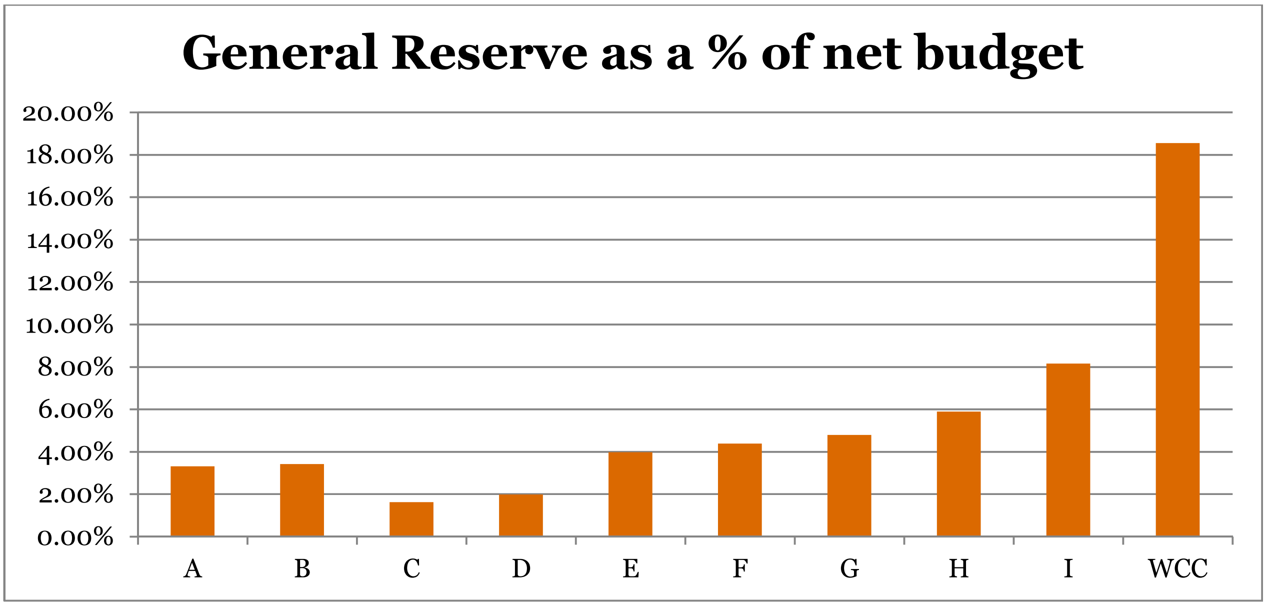
Graph 7: Council tax rate rise assumptions



Reserves – General Fund

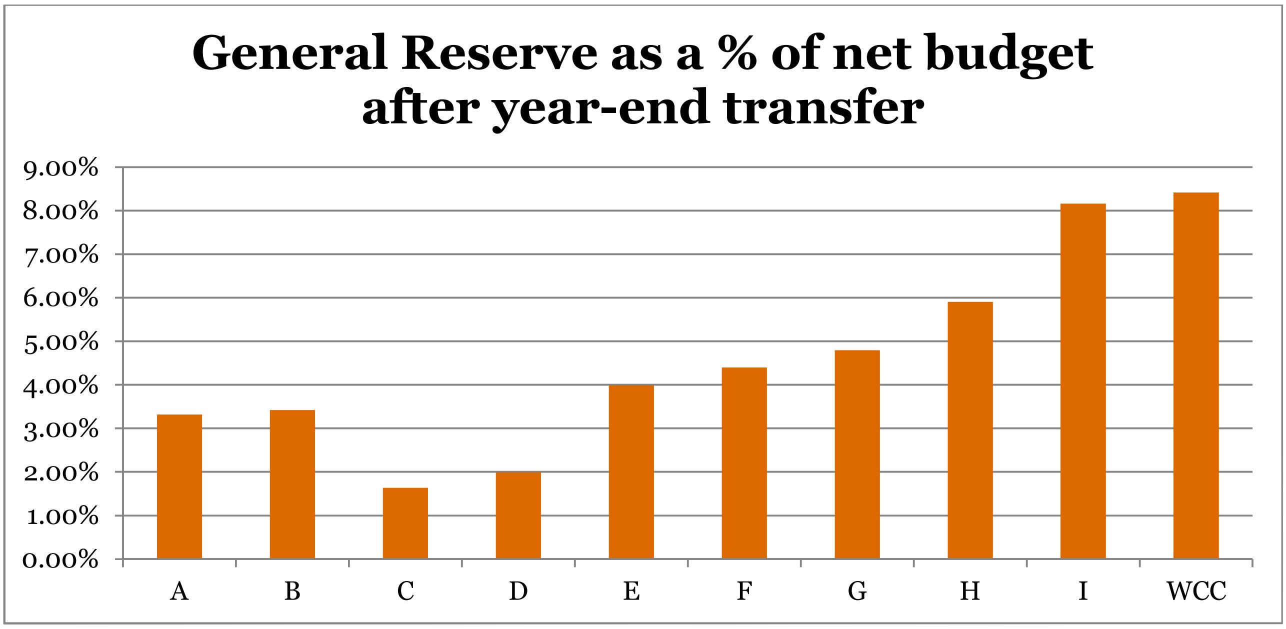
You have a policy to maintain your general fund balance at a level no lower than £15m. At the end of the 2010/11 financial year you were holding approximately £39.5m of general fund reserves, which represented 16.2% of your net expenditure. At the time of our work being completed, this was expected to rise to £43.1m at the end of the 2011/12 financial year. As a percentage of your net budget requirement this would have put you significantly above all of our benchmark group of Local Authorities where this information was available. The range at other Councils went from approximately 2% to 8% of net expenditure:

Graph 8: General Reserve level



However, as part of the closure of the 2011/2012 accounts you took the decision to transfer £20m out of general reserves into the new specific reserve 'Budget Future Years Support Reserve' in order to provide support for the difficult period of the MTFS 2013/14 to 2017/18. This still puts your level of general fund reserve at the upper end of our benchmark group but brings you much further in line with comparative Councils:

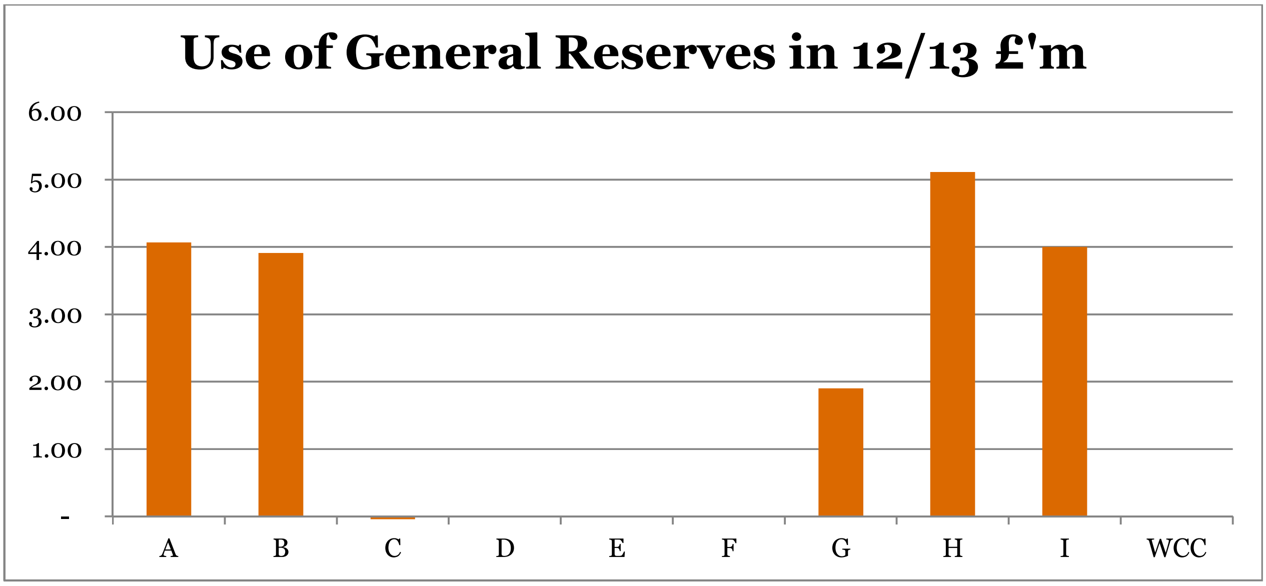
Graph 9: General Reserve level after year-end transfer



This does provide the Council with somewhat of a 'safety net'. This should however not be overstated, given the budget risks identified within this report. The Council must, as a minimum, continue to consider what it deems to be an appropriate general fund level on an annual basis given the risks it faces and update the MTFS as required.

It should also be noted that the Council does not plan to use general fund reserve to balance the budget in the coming financial year, unlike some others:

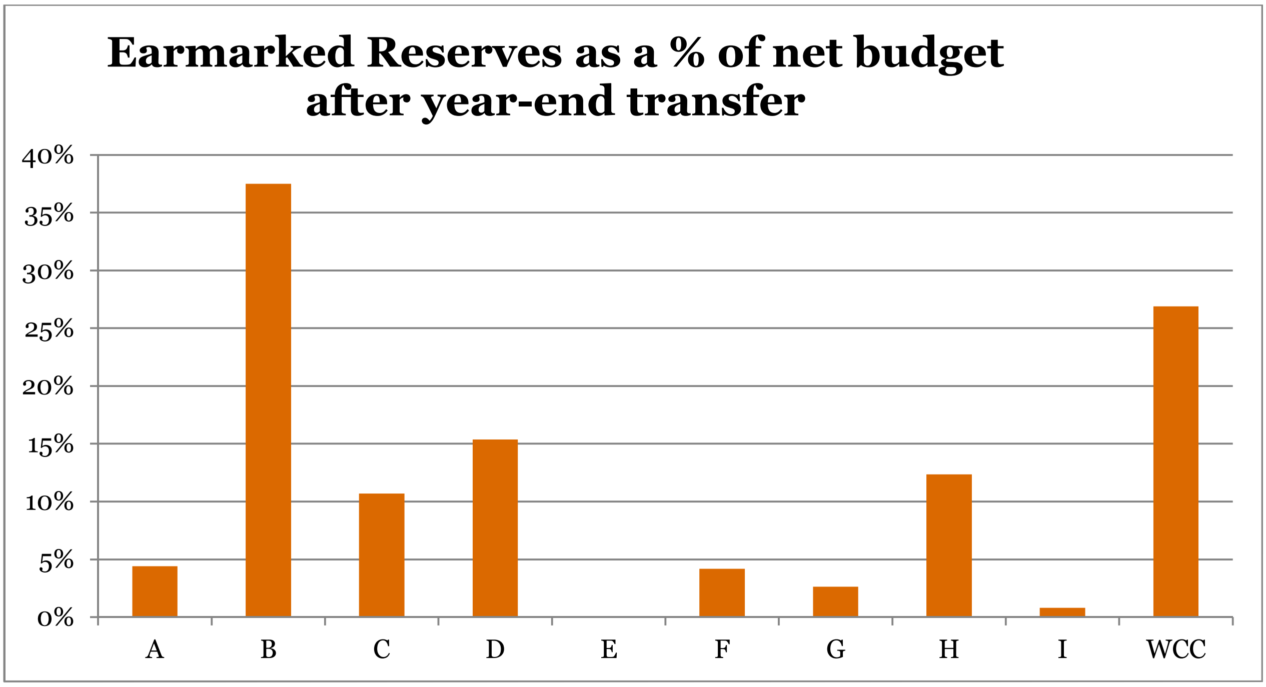
Graph 10: Use of General Reserves in 12/13



Reserves – Earmarked Reserves

At the start of the MTFS period your earmarked reserves are higher than most within our benchmark group. This position has been become even more pronounced after the year-end transfer to the earmarked 'Budget Future Years Support Reserve' referred to in the previous section.

Graph 11: Earmarked Reserves level after transfer



Delivery and risk management

Clearly delivering your plans will be a challenge. You recognise the need to continue to manage the risks associated with the delivery of your MTFS. Our view of the main risks can be summarised as follows:

Achievability: you may not be able to achieve the savings you want either from a service reduction or through efficiencies.

Timing: The timing of savings, service reductions and funding announcements will impact how you deliver against your MTFS.

Assumptions: We have gone some way above to assess the assumptions you have applied in your MTFS. You need to continue to monitor your progress against the plan, paying particular attention to changes in the original assumptions you have made and revisiting financial plans in order to deliver a balanced budget. Reserve balances will also need to be monitored to ensure that they remain adequate.

Conclusions

Summary of work done

We have benchmarked the MTFS assumptions you have used in the following key areas:

- Inflation (pay and non-pay expenditure);
- Spending reductions and savings;
- Formula grant allocation;
- Council Tax; and
- Use of reserves.

Conclusions

On the basis of this work we have concluded that:

- the assumptions you have used in setting your MTFS are broadly in line with other similar authorities;
- we have identified no significant concerns and there are no areas where further risk based audit work is required at this time; and
- we have identified no issues which would lead to an unqualified value for money conclusion.

In the event that, pursuant to a request which Wolverhampton City Council has received under the Freedom of Information Act 2000, it is required to disclose any information contained in this report, it will notify PricewaterhouseCoopers (PwC) promptly and consult with PwC prior to disclosing such report. Wolverhampton City Council agrees to pay due regard to any representations which PwC may make in connection with such disclosure and the Wolverhampton City Council shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, the Trust discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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