Paul Satoor Chief Executive
Wirral Metropolitan Borough Council
Wallasey Town Hall
Brighton Street Wallasey
Wirral
CH44 8ED

Grant Thornton UK LLP
The Colmore Building
20 Colmore Circus
Birmingham
B4 6AT

T +44 (0)121 212 4000
F +44 (0)121 212 4014

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Dear Paul

Wirral Council – Audit of Accounts 2019/20 – Financial sustainability

I write further to our discussion regarding the Council's financial position.

Background

It is pleasing to note that the Council has acknowledged its financial challenges and has taken positive steps to manage them. In its medium term financial plan ('the plan') and its financial resilience strategy the Council sets the financial challenge facing it and highlights a funding gap of almost £30m a year for each of the next five financial years. While acknowledging the challenge 'the plan' clearly articulates the Council's response and sets out a programme of:

- Income generation – by investing in projects to create economic and housing growth, which in turn will generate additional business rates and council tax for the council
- Delivering Leading Edge Services – finding new ways of delivering services
- Ensuring Efficiencies – by challenging every pound spent
- Empowering Communities – by encouraging people to become independent and ensuring opportunities for SMEs.

This focus on its finances has been supported by a change in governance with the new committee system and the introduction of new political and executive leadership. In addition, I note the Council's ambitious plans for regeneration and services. It is positive that these changes have been put into place.

Overview of financial position

As part of our 2019/20 audit we have been monitoring the Council's financial position. We are undertaking similar reviews at all Council's due to the impact COVID 19 on all councils. This is important at Wirral due to the Council's own relatively low level of general fund and earmarked reserves. From my discussions with you and the Director of Resources, and my review of the 27 July 2020 Cabinet Report entitled 'Revenue Monitoring 2020/21, Quarter One I note that the impacts on Wirral are significant. I understand that the Council has now applied for a capitalisation directive to support its financial position in 2020/21 and 2021/22.

I have set out my thoughts and concerns below.

Prior financial periods

I note that the Council developed 'the plan' from a relatively weak financial position.

By the end of the 2017/18 financial year General Fund Balances were at £24.856m but £15m of these reserves were used in 2018/19 to support children's social care services following an inadequate assessment from the CQC. As you are aware, in our 2018/19 Audit Findings Report (AFR) we reported that:

'The general fund balance at March 2019 is £10.7m which is a decrease of £14.2m from the closing balance at March 2018. The Council has set a minimum general fund balance of £10m going forward which it considers to be a reasonable level in case of unforeseen financial difficulties. Overall available revenue reserves has fallen from £106m in March 2015 to £70m at March 2019. Looking forward, the revised MTFS shows an accumulative budget gap of £67m over the four years with expected savings of £45m to be achieved in 2019/20 to balance the budget. The Council will no longer be looking to rely on one off funding to meet the provision of services. It is however, anticipating income to be generated through the Growth Company, with £5m expected to be received in 2019/20.'

In 2019/20, the Council set a budget of £273m. The budget assumed the use of £4.5m from earmarked reserves and £7m from the use of flexible capital receipts. The budget was later increased to £277m. While the final outturn for the Council was a net budget spend of £277m this was after the use of £26m of reserves.

In my view, the use of reserves is significant and is not sustainable. The Council needs to take urgent action to reduce its reliance on reserves in setting a balanced budget.

2020/21

The Council set a budget of £304m for 2020/21. This included financial pressures of £37.5m, offset by savings of £29.9m. The Council anticipated using £6.4m of reserves to balance its financial position. Of this £2.4m was expected to come from Earmarked Reserves and £4m from capital receipts for transformational spend included in revenue budgets.

The July Cabinet report on the Council's financial position reflects a deficit financial position following the impact of COVID. In the report the Council sets out a forecast budget deficit of c.£30.4m for the 2020/21 financial year. The report to Cabinet states :

'The year-end forecast recorded as part of June's financial monitoring activity represents an adverse variance to revenue budget of £30.432m; this comprises:

- £23.987m forecast variance in relation to revenue budget overspends (including a forecast increase to in-year, earmarked reserves of £0.546m), the adverse position has arisen largely due to matters arising through the COVID-19 pandemic.

- £2.150m forecast capital receipts, which support the revenue budget position via flexible use of capital receipts and;
- £4.296m gap in direct COVID-19 funding against forecast requirements.'

The shortfall is driven by a number of matters and relate to Neighbourhoods, Cross Cutting initiatives and COVID funding. My understanding from reviewing the report are that the shortfalls are as follows: Neighbourhoods (£12.7m) – this is primarily due to leisure lost income, Cross cutting initiatives (£11.7m)

– the Council has been unable to deliver these initiatives, and Covid Funding

– a short fall in Government funding against the Council's expenditure (c.£4.2m). While I understand that some income is expected from the Government for reduced Neighbourhoods income the remaining shortfall is significant and if not addressed would consume the majority of the reserves available to the Council.

I also note that the Council has ambitious capital expenditure plans. Most notably, an investment of £32m in economic growth, particularly investments properties £8.5m and Wirral Waterfont £15m. There is also a planned transfer of £4.5m from capital to revenue for 'transformational capitalisation'. The Council's current financial position would appear to cast doubt over its ability to take these programmes forward and remain financially sustainable.

The Council will need to focus on the delivery of its MTFS including finding new ways of income generation, delivering services, delivering efficiencies and empowering communities. It is probable that it will need to go beyond its MTFS and look at service reductions. It will also need to consider any income generation schemes against the investment resources now available to it and the payback periods.

Reserves

In terms of the Council's reserves, it had £97m of reserves available to it at 31 March 2020.

From our 2018/19 AFR it appears that in previous years the Council has used reserves to balance its budget. In my view it is not prudent for councils to use non-recurrent money from reserves to fund recurrent expenditure.

I also note that while the remaining reserves appear to be significant the vast majority are not available to the Council to fund revenue expenditure. Our review of reserves indicates that £20m relates to ringfenced grants for capital schemes, £7m are school balances, £25m relate to COVID related grants,
£8m relates to insurance funds and £4m to the business rate equalisation reserve. As such these reserves are not available to the Council to cover a shortfall in its revenues or non-delivery of savings plans.

After setting aside these reserves the Council has c £31m of reserves available to it to meet service overspends. While this appears to be a significant sum in my experience it is not sufficient. In particular, I do not consider that reducing the General Fund Reserve below £10m would be appropriate and that this would leave the Council exposed should a financial crises arise. As such the Council has c£20m to deal with any savings shortfall. If the Council did utilise the remaining earmarked reserves to meet the £30m shortfall in 2020/21 I note that this would not be sufficient and that the Council would be reducing its remaining balance of reserves (c £20m) to £0.

Council response

On our call we discussed the actions that the Council is taking in response to its finances. I was pleased to understand that you have already engaged with MHCLG with regard to a capitalisation directive for 2020/21 and 2021/22 revenue expenditure and that you have now made your initial submission. I also note that the Council has engaged with the Local Government Association with regard to its submission to MHCLG for the capitalisation directive.

As per the analysis above, the agreement of a capitalisation directive for 2020/21 is important to ensure that the Council can meet the short term financial shortfall. I also note that the Cabinet Report shows a revenue shortfall of £33.8m for 2020/21. As it now appears that the pandemic will continue into the new financial year and it appears uncertain as to whether the Council will be able to deliver this level of savings it is important that a capitalisation directive is secured for 2021/22.

If a capitalisation directive is not secured for 2020/21 and / or 2021/22, in my view, the Council may need to consider its response under S114 of the Local Government Finance Act 1988. Section 114 (3) dictates that: “The chief finance officer of a relevant authority shall make a report under this section if it appears to [him] that the expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely to exceed the resources (including sums borrowed) available to it to meet that expenditure”.

I note that the Council is already taking a number of other actions. For example:

- Newton Europe: To undertake an initial diagnostic on Adults Social Care and Children’s Social Care.
- C.Co Commissioned to carry out an exercise to determine the cost of care in adult care and health
- Partners for Change: In discussion with regards to their “Three Conversations Programme” aligned with Social Work teams. The aim is to reduce demand into the care sector
- A Children’s Transformation programme is in the early stages of formulation.

It is positive to see the actions taken by the Council. It is important that the Council continues to develop these savings plans as the capitalisation directive will only provide the Council with a short term solution. Therefore the Council’s focus needs to be on how it can return to financial balance.

I note that additional Government funding for the region and for councils has been announced in recent days. This will support the Council in moving to a more financially sustainable position.

Audit Response

I am aware that the Council is intent on resolving this situation and that it and local people have been impacted significantly by the current pandemic. I also recognise that the Council will need to balance any action it takes to strengthen its finances against the potential impact on the well-being of local people.

Despite this focus it is important that the Council ensures that it is financially sustainability. At present I consider that the response is appropriate. It is, however, important that the Council:

- secures agreement with MHCLG for a two year capitalization directive
- continues to take action to reduce its expenditure and ensures that it is not reliant on use of reserves or any further capitalisation directive.

I will continue to liaise with you and the Council during the next few months as you seek to stabilise the financial position. As we discussed when we met, I will need to consider my responsibilities under the Local Audit and Accountability Act. It is possible that should the Council not stabilise its financial position or does not take the steps needed to do so that I will have to consider exercising the formal powers available to us as auditors.

Please can you bring this letter to the attention of the wider Council and in particular the Policy and Resources Committee.

Please let me know if you wish to discuss any of the matters raised

in this letter. Yours sincerely

Mark C Stocks
Partner, Head of Public Sector Assurance,
Audit Grant Thornton UK LLP

cc. Shaer Halewood