

# **Welsh Government Consultation on the Draft Local Government (Wales) Bill**

**A Submission by:**

**The Chartered Institute of Public  
Finance and Accountancy**

**February 2016**

**CIPFA, the Chartered Institute of Public Finance and Accountancy**, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

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## **1. Executive Summary**

- 1.1 CIPFA recognises the efforts that have gone into the draft bills supporting regulatory impact assessment (part 1) in terms of identifying the costs associated with reform and merger options. However, there are omissions and exclusion of costs such as council tax harmonisation and transition committee costs that could total up to £73.5m<sup>1</sup> based on CIPFA's previous research. As a result, we believe that a full and complete presentation of the transitional costs to be incurred through the reform process is now required.
- 1.2 A clear presentation of the full costs involved is essential to enable councils to plan for the costs of merger in advance of anticipated savings, set the appropriate levels of council tax and ensure adequate reserves to maintain financial sustainability. Considering the timeframe's laid out in the consultation, we believe councils will need to start planning for the costs in the 2016 calendar year.
- 1.3 CIPFA's assessment of the financial impact of reform is that the initial costs will place significant, and in some cases, unsustainable additional financial pressures on councils. Our research shows that councils had £196.3m of freely available reserves as at 31<sup>st</sup> March 2015 to support funding reform and merger costs without raising additional council tax. The Regulatory Impact Assessment supporting the draft bill identifies a maximum cost of £253.7m (excluding council tax harmonisation and transition committee costs) for the Welsh Government's preferred council configuration. This level of costs will require support, either through central government direct support or by allowing flexibilities in the mechanisms to fund these costs, in order to minimise the impact on the council tax payer.
- 1.4 CIPFA notes the introduction of a general power of competence within the draft legislation. However, we believe that in order to enhance the ability of local government to use these powers, the nature of some of the limitations on the use of the powers should be reviewed. This will be important in enabling councils to cope with the continued financial pressures of restricted funding.
- 1.5 The draft legislation makes provision for assessment of governance arrangements in county councils. CIPFA believes that there is potential for duplication and overlap with existing responsibilities of the Auditor General for Wales in ensuring economy, efficiency and effectiveness in the discharge

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<sup>1</sup> CIPFA Report for the Welsh Local Government Association, November 2014 (Total of estimates for Tax Harmonisation costs £56.7m plus Change Programme Teams £16.8m)

of a councils duties. We would recommend that the Auditor General's responsibilities and independence in forming a view on these matters is clarified within the draft bill or any supporting regulations.

## **2. Transitional Costs of Reform**

2.1 In 2014 CIPFA completed a report for the Welsh Local Government Association<sup>2</sup> which contained an assessment of the transitional costs of reform of Local Government in Wales. This report, based on a 12 council model proposed in the White Paper,<sup>3</sup> suggested a cost range of between £159.7m at the lower end of estimates to £267.9m at the upper end of estimates.

2.2 The current consultation document on the draft local government (Wales) Bill and explanatory memorandum supports the Welsh Government stated preference for a future configuration for local government in Wales based on 8 or 9 new principal authorities. The Regulatory Impact Assessment (RIA)<sup>4</sup> provides a cost assessment for this model of between a minimum of £104.4m and a maximum of £253.7m total cost. This includes both Welsh Government and Local Government total costs.

2.3 While the two assessments above (CIPFA and the Welsh Government's preferred option) are based on two different council configurations, it is worth noting some fundamental differences within the two estimates:

- The most notable difference is the omission of any cost estimates for council tax harmonisation within the RIA.
- Secondly, the costs associated with the set-up and on-going work of the transition committees is also excluded from this RIA.

2.4 CIPFA's view on Council Tax Harmonisation is that this is possible under a number of scenarios, i.e. councils may level down to the lowest, they may equalise around the weighted average or they may level up to the highest. In terms of ensuring local financial stability the third option is the most prudent. However, even under this scenario there is a significant amount of income foregone. CIPFA's previous research shows:<sup>1</sup>

- For two of the mergers rates harmonise in year 1

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<sup>2</sup> CIPFA Report for the Welsh Local Government Association: Report on the Transitional Costs, Benefits and Risks of Local Government Reorganisation, November 2014

<sup>3</sup> Welsh Government White Paper – Devolution, Democracy and Delivery, Reforming Local Government: 8 July 2014

<sup>4</sup> Draft Local Government (Wales) Bill – Regulatory Impact Assessment, Part 1 Table 15: Option 3b summary of estimated costs.

- For another merger it takes 6 years and;
  - For a third merger harmonisation does not occur until after year 6.
- 2.5 The potential income foregone could be just under £57m over 5 years based on holding higher rates constant while the lower rates catch up. This is a significant cost element within our overall costs stated in 2.1 above and represents a significant omission from the RIA assessment. This estimate would need to be reviewed depending on the final selection for council configurations.
- 2.6 The regulatory impact assessment that was previously completed in support of the Local Government (Wales) Act 2015<sup>5</sup> indicated that the costs of transition committees would be in the region of £2.0m. This was based on two options of either one voluntary merger and eight main mergers or two voluntary mergers and seven main mergers. This cost was spread over a period of four years from 2016/17 to 2019/20 and includes only limited administrative staff support and allowances for up to 5 councillors.<sup>6</sup>
- 2.7 CIPFA's assessment of programme change costs which includes programme management, transition management, workforce remodelling and organisational development amount to £16.8m based on approximately up to 10 people per council being involved for a period of 2 years.
- 2.8 The impact of the costs of transition committees has also been excluded from the RIA for the current consultation. This and the omission of Council Tax Harmonisation assessments means that there is an ability to proceed with a process of mergers without a consideration of the full cost implications being understood. We believe that this limits the ability of councils to adequately plan and manage the financial implications of the transition process.
- 2.9 There is a further issue to consider concerning the timeframes within which the financial planning for transitional costs should take place. If elections are held on 4<sup>th</sup> May 2017 for the existing authorities,<sup>7</sup> transition committees could be in place for the financial year 2017/18. This would mean that any costs to be borne by councils for transition committees in that year (2017/18) would need to be planned for and understood during the budget

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<sup>5</sup> Local Government (Wales) Act 2015 – makes provision for certain preparatory work to enable a programme of local government mergers and reform. This includes the setting up of transition committees.

<sup>6</sup> Tables 7, 8 and appendix A of the Local Government (Wales) Bill Explanatory Memorandum incorporating the Regulatory Impact Assessment and Explanatory Notes, January 2015  
<http://www.senedd.assembly.wales/documents/s35990/Local%20Government%20Wales%20Bill%20Explanatory%20Memorandum.pdf>

<sup>7</sup> Chapter 2, Welsh Government Consultation Document – Draft Local Government (Wales) Bill and Explanatory Memorandum – proposed transitional arrangements for election cycles. November 2015

and planning cycle taking place in the autumn of 2016. This cycle results in the setting of council tax in early 2017 for the 2017/18 financial year.

- 2.10 The National Assembly for Wales Finance Committee recommended in its report on the 2015 Act<sup>8</sup> that further details on the costs and benefits of mergers should be provided. It also recommended that the Welsh Government works with local government to prepare a clear plan for how it will estimate the costs of mergers. CIPFA believes that while the estimates contained in the current RIA for this consultation go a long way to addressing these concerns, significant costs are not included and there is now a pressing need to fully identify these costs for local government financial planning needs.

### **3. Financing Transition**

- 3.1 The RIA clearly identifies that, taking the preferred option 3b, costs will be included between 2016/17 and out to potentially 2023/24. Anticipated savings on the other hand start occurring post 1 April 2020 and have been assessed over a ten year period.<sup>9</sup> The timing of costs versus savings will mean that local government will need to consider how it finances the significant initial costs before and anticipated savings occur.
- 3.2 The bulk of costs anticipated within the RIA are by their nature revenue expenditure and therefore are accounted for within the year in which they occur. This means that in the absence of any alternative sources of income or financing to cover this additional expense, the council will need to make use of its reserves or increase either its council tax charge or any other fees and charges it has the ability to raise.
- 3.3 Our review of the impact of these costs on council reserves suggests that there would be financial sustainability issues for some councils in the short-term. The Welsh Government has reported on the level of reserves within local government.<sup>10</sup> This shows that overall usable reserves within local government have seen small increases in recent years (£1,404.0m at 31 March 2014 to £1,427.4m at 31 March 2015). However, identifying the nature of those usable reserves shows the following position:

#### **Usable Reserves in Local Government in Wales:**

<b>Usable Reserves</b>	<b>2015 £m</b>	<b>2014 £m</b>
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<sup>8</sup> National Assembly for Wales Finance Committee - Report on the Local Government (Wales) Bill, May 2015

<sup>9</sup> Tables 14 and 15 of the Regulatory Impact Assessment – Draft Local Government (Wales) Bill, Part 1.

<sup>10</sup> Welsh Government – Whole of Government Accounts 2014-15 – Local Authority Reserves (LG/WGA/02) October 2015

Earmarked Reserves	832.3	823.6
Capital Receipts Reserve	189.3	158.4
Capital Grants Unapplied	64.6	68.1
Schools Reserve	64.2	61.4
Housing Revenue Account Balance	80.7	85.2
General or Unallocated Reserves	196.3	207.3
<b>Total Usable Reserves at 31 March</b>	<b>1,427.4</b>	<b>1,404.0</b>

- 3.4 The above figures identify that out of the reserves classified as usable in local government, only a small proportion (13.7% or £196.3m at 31 March 2015) are in fact available to potentially finance additional revenue spending on transition costs. The level of unallocated reserves have fallen by £11.0m in 2015 (£207.3m down to £196.3m).
- 3.5 CIPFA have also reviewed the financial statements of individual councils and concluded that while there are significant levels of earmarked reserves, their purpose is clearly identified and this would mean that there is limited scope for councils to re-classify earmarked reserves to support transitional or merger costs as they are incurred. In summary, if the maximum level of spending was reached as identified in the RIA, the currently available unallocated reserves of councils across wales would be more than fully exhausted. It should be noted that this estimate does not include council tax harmonisation costs or transition committee spending as noted in section 2 above.
- 3.6 Our review of the recent Welsh Government draft budget 2016/17 announcement showed that local government is facing a 2.0% reduction in its allocation for 2016-17.<sup>11</sup> The key areas of reduction in the budget come from reduction to funding support from the Welsh Government to local government of £55m and reductions to the allocations for local government service improvement, collaboration and democracy of £32m. The latter reduction comes at a time when local government is entering a period of reform and reorganisation and where there will be financial pressure to fund the reform and deliver on potential efficiencies and savings in the future.
- 3.7 We believe that there is a financial case to be made that additional support for council spending on transition committees and/or merger costs should be made available. This could take the form of direct revenue support from the Welsh Government or through other flexibilities allowed to local government in order to mitigate the short-term impact on reserve levels and overall financial sustainability.

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<sup>11</sup> Welsh Government – Draft Budget 2016/17, Draft Budget Action Tables December 2015.  
<http://gov.wales/funding/budget/draft-budget-2016-17/?lang=en>

3.8 Using the recent local government reorganisation in Northern Ireland as an example. The Department of the Environment provided a package of support agreed by the Northern Ireland Assembly. In February 2013 a funding package from the Northern Ireland Assembly amounting to £47.9m was agreed. This covered key areas such as system convergence and rates harmonisation measures.<sup>12</sup> The Department of the Environment in Northern Ireland have also enabled, through regulation, the ability for councils to capitalise certain revenue costs for funding purposes, mitigating the impact on rate payers.

#### **4. General Power of Competence**

4.1 CIPFA supports the aim of providing a structure for local government that allows services to be provided more effectively and that decisions on funding are taken at the right level.<sup>13</sup> The provision of a general power of competence within the bill is supportive of providing additional powers and enables councils to extend their services and support for the benefit of their communities.

4.2 In summary, the general power of competence, as contained in part 2 of the Bill, enables councils to do things:

- An individual may generally do
- Anywhere in the UK or elsewhere
- For a commercial purpose or otherwise, for a charge or without a charge
- Without the need to demonstrate that it will benefit the authority, its area or person's resident or present in its area

Evidence does exist however that these powers do come with limitations which, given the current financial pressures facing local government, are likely to limit their effectiveness.

4.3 The Local Government Association in its report<sup>14</sup> on this power noted that the constraints on the use of the general power of competence fall into three areas:

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<sup>12</sup> Northern Ireland Assembly, Research and Information Service – Bill paper on the Local Government Bill in Northern Ireland, September 2013

<http://www.niassembly.gov.uk/globalassets/Documents/RaISe/Publications/2013/environment/12013.pdf>

<sup>13</sup> CIPFA Manifesto 2015 – A call for sustainable public finance

<sup>14</sup> Local Government Association: The General Power of Competence – Empowering councils to make a difference, July 2013

- Trading restrictions
- Charges and;
- Legal restrictions

- 4.4 The draft bill does not specifically identify the use of Community Interest Companies (CIC) or similar as legal entities for the purpose of commercial activity. The draft bill limits the number of company structures to companies limited by guarantee or shares and industrial and provident societies.<sup>15</sup> The availability of CIC's as a structure provides the ability to set up an organisation specifically designed for community benefit and not for private advantage. This is achieved by a community interest test and asset lock, which ensure that the CIC is established for community purposes and profits are dedicated to those purposes.<sup>16</sup>
- 4.5 Limits on charges in the draft bill mean that only discretionary services can be charged for. Further, the level of charges should be set so as the costs of providing the service are recovered without generating any profit or surplus.<sup>17</sup> This limits the ability of the council to raise any additional revenue or to influence or incentivise behaviours within the community.
- 4.6 Legal restrictions occur in that the draft bill does not extend the powers of council to create new byelaws or undertake enforcement. The Local Government Association report<sup>13</sup> suggests that there is a common misunderstanding in this area that the general power of competence does allow this. The legislation as drafted merely extends power to the council to do what 'individuals' normally do, which does not extend to creating new byelaws or enforcement. There also needs to be some clarity in support of these powers on undertaking activities in supporting local businesses and employment where this may come into conflict with limitations on the use of state aid under EU rules. This might include, for example, creating a fund to provide support loans where banks do not.<sup>18</sup>

## **5. Assessments of Governance Arrangements**

- 5.1 Under the provisions contained in the draft bill, assessments of governance arrangements can be made in three ways.<sup>19</sup> This can be achieved through a system of self-review, through peer reviews and through the relevant regulators completing a combined assessment.

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<sup>15</sup> Local Government (Wales) Bill – Draft for Consultation – Chapter 2 section 26.

<sup>16</sup> The Regulator of Community Interest Companies website:

<https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies>

<sup>17</sup> Local Government (Wales) Bill – Draft for Consultation – Chapter 2 section 25.

<sup>18</sup> Department of Business Innovation and Skills – State Aid: The Basics Guide, July 2015

<sup>19</sup> Local Government (Wales) Bill – Draft for Consultation – sections 116 to 127.

- 5.2 Relevant regulators under the draft bill include Her Majesty’s Chief Inspector of Education and Training in Wales, Welsh Ministers exercising their functions under the Social Services and Wellbeing (Wales) Act 2014 and the Auditor General for Wales. While these regulators all have specific areas of responsibility, they are required in the draft legislation to produce a combined assessment in relation to each council. The assessment will look at how each council has performed its duties under the act in regard to securing:
- a) good governance,
  - b) accountability and;
  - c) economy, efficiency and effectiveness in the use of its resources.<sup>20</sup>
- 5.3 Clear responsibilities already exist under the Public Audit (Wales) Act 2004 for the Auditor General for Wales to undertake or promote studies designed to enable recommendations to be made for improving economy, efficiency and effectiveness in the discharge of the functions of local government bodies in Wales.<sup>21</sup> We would therefore see some duplication and/or overlap of responsibilities here in regard to ensuring economy, efficiency and effectiveness. Further, we believe that there needs to be clarity that the Auditor General for Wales should have overall responsibility for concluding whether or not a local government body in Wales has established proper arrangements for economy, efficiency and effectiveness.
- 5.4 Clarity on this topic is important to assist in addressing any potential areas for disagreement between the regulators in their findings on combined assessments. This will also help to ensure the complete independence of the Auditor General for Wales.

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<sup>20</sup> Section 111 (1) of the Local Government (Wales) Bill – Draft for Consultation.

<sup>21</sup> Public Audit (Wales) Act 2004 – Section 41 (1)