Somerset West and Taunton Council

Audit, Governance and Standards Committee – 1 February 2021

Assessment of Going Concern Status – Somerset West and Taunton Council

This matter is the responsibility of Councillor Henley, Corporate Resources

Report Author: Paul Fitzgerald, Assistant Director – Finance (S151 Officer)

1 Purpose of the Report

1.1 To inform the Audit, Governance and Standards Committee of the Assistant Director Finance and S151 Officer's assessment of Somerset West and Taunton Council as a "going concern" for the purposes of producing their Statement of Accounts for 2019/20.

2 Recommendations

2.1 Members review and note the assessment made of the Council's status as a "going concern" as a basis for preparing their 2019/20 Statement of Accounts.

3 Risk Assessment

3.1 There is a presumption that as a local authority the Council is a going concern. However, for the purposes of preparing the accounts the assessment is important as if the assessment for financial reporting purposes is the Council is not a going concern, this places ongoing service delivery, and asset and liability valuations at risk. This is mitigated through effective governance and financial control.

4 Background and Full details of the Report

4.1 The concept of a "going concern" assumes that an authority, its functions and services will continue in operational existence for the foreseeable future. This assumption underpins the accounts drawn up under the Local Authority Code of Accounting Practice (the Code) and is made because local authorities carry out functions essential to the local community and are themselves revenue-raising bodies (with limits on their revenue-raising powers arising only at the discretion of central government). If an authority were in financial difficulty, the prospects are thus that alternative arrangements might be made by central government either for the continuation of the services it provides or for assistance with the recovery of a deficit over more than one financial year.

4.2 The Code also confirms that transfers of services under combinations of public sector bodies (such as local government reorganisation) do not negate the presumption that the financial statements are prepared on a going concern basis.

4.3 If the assessment determined that the Council is not a "going concern", particular care

would be needed in the valuation of assets, as inventories and property, plant and equipment may not be realisable at their book values and provisions may be needed for closure costs or redundancies. An inability to apply the going concern concept would potentially have a fundamental impact on the financial statements.

4.4 The council is required to compile the Statement of Accounts in accordance with the current Code of Practice on Local Authority Accounting (hereafter referred to as the Code) as published by the Chartered Institute of Public Finance and Accountancy (CIPFA). In accordance with the Code the Statement of Accounts have been prepared assuming that the council will continue to operate in the foreseeable future and that they are able to do so within the current and anticipated resources available. By this, it is meant that the council will realise its assets and settle its obligations in the normal course of business.

4.3 The main factors which underpin this assessment are:

- The Council's current financial position;
- The Council's projected financial position;
- The Council's governance arrangements;
- The regulatory and control environment applicable to the Council as a local authority.

5 Current Position

5.1 2019/20 is the first year of operation for Somerset West and Taunton Council, with the local authority functions and associated assets, liabilities, rights and obligations having transferred from the predecessor authorities on 1 April 2019. The Shadow Council set a balanced budget for 2019/20, and as shown below the General Fund reported a significant underspend for the year and the Housing Revenue Account came in on budget.

5.2 Financial risks during the year were influenced largely by the new Council bedding in and the organisation's management and workforce focussing on stabilising and improvement following the major changes arising through the transformation programme in the previous two years. During 2019/20 four new Director posts were added to the structure, and the leadership team has worked through a process of reshaping the organisation structure to align with four new directorates. Staff capacity has been increased to stabilise and manage service standards following the period of disruption, and this higher cost base has been added into the Medium Term Financial Plan (MTFP) estimates to establish an up to date assessment of baseline costs for financial planning purposes.

5.3 The financial risk environment has been significantly influenced, mainly after the reporting date for last year's accounts, by COVID-19 and the impact on service costs and income for the Council. Government emergency funding and income loss compensation scheme have largely mitigated the additional net costs for the Council, but additional funding from reserves is needed in 2020/21. SMT and the S151 Officer have prudently strengthened reserves in view of this immediate risk and also with the aim of supporting the budget over the next 2-3 years. The MTFP assumptions and forecasts have been updated with reasonable estimates of the ongoing impact of COVID on costs and income, however this remains an area of uncertainty that builds risk into the accuracy of those forecasts.

5.4 The Council's updated Financial Strategy, agreed by the Executive in October 2020,

highlights significant medium term financial pressures, and the financial plan looks to reduce these pressures by using reserves in 2021/22 and 2022/23. Despite this, the challenge in 2022/23 in particular will require action to manage costs and grow income in order to achieve a balanced budget.

5.5 Despite the forecast included in the MTFP, financial forecasting in respect of funding carries a high degree of uncertainty, making medium-long term financial planning extremely difficult. The full Comprehensive Spending Review due in 2019 was deferred (due to UK exiting the EU) with only a 1-year finance settlement provided by Government for 2020/21. The CSR and Autumn Budget have also been delayed in 2020, together with anticipated reviews of business rates retention funding and New Homes Bonus grant, (due to UK exiting the EU and COVID) so funding estimates in our MTFP are currently prepared on a 'roll-forward' basis in the absence of any certainty around possible changes.

5.6 Despite the uncertainty, the current financial position is underpinned by healthy reserves, providing a good degree of financial resilience in the short to medium term. The Council has absorbed the in-year pressures from COVID and also provided additional funding to support economic recovery. The Council is holding healthy general reserve balances, and also prudent reserves to mitigate volatility in business rates funding and property investment income.

5.7 The prospect of structural change for local government in Somerset is likely, with the districts in Somerset and the County each presenting proposals for unitarisation. Implementing any change will require up-front investment, and would be expected to offer financial savings in the longer term. No assumptions for costs and income related to structural change are currently included in the MTFP pending any decision by Government.

6 The Council's Year End Position

General Fund

6.1 The financial performance in 2019/20 resulted in a net underspend of £1.836m (8.2% of Net Budget) for the year. As at 31 March 2020 the Council held a General Reserves Balance of £4.522m (minimum level is set at £2.4m) and held Earmarked Reserves totalling £20.586m. The Earmarked Reserves balance increased in 2019/20 by £2.344m during the year mainly due to monies set aside for Economic Development Initiatives and the Investment Risk Reserve. The adequacy of reserves, and the ongoing requirement for specified earmarked reserves, is reviewed on a regular basis. It is recommended that £1.2m from earmarked balances is returned to General Reserves in 2021/22, together with £3.9m from NHB earmarked reserve and £1m from Business Rates earmarked reserve. This reflects the leadership team's objectives for providing resilience and additional resources to mitigate COVID costs and support economic recovery, and provide flexibility to soften the project budget gap in the MTFP in the next 2-3 years.

Housing Revenue Account

6.2 The financial performance in 2019/20 resulted in a small net underspend of £8k (0.03% of Gross Income Budget). As at 31 March 2020 the Council held an HRA Reserve Balance of £2.700m (minimum level is set at £1.8m). In addition there are HRA Earmarked Reserves totalling £1.648m to support specific issues. The level of adequate reserves, and the ongoing requirement for specified earmarked reserves, is reviewed on

an annual basis.

Table 1 – Revenue Reserves Summary

	General Fund		HRA		
	General £m	Earmarked £m	General £m	Earmarked £m	Total £m
Opening Balance	2.857	18.242	2.718	2.719	26.509
Movement in year	1.665	2.344	-0.017	-1.071	2.947
Closing Balance	4.522	20.586	2.701	1.648	29.456
Minimum Balance	2.400		1.800		

7 The Council's Projected Financial Position

7.1 The Council has maintained a medium-term financial plan (MTFP) that is updated annually to reflect a five-year assessment of the Council's spending plans and associated funding. It includes the ongoing implications of approved budgets and service levels and the revenue costs of the Council's capital programme, as well as the management of debt and investments.

7.2 A balanced budget for 2020/21 was approved in February 2020, which included allocating an additional £300k to general reserves.

7.3 The 2020/21 budget has been reorganised in the early part of the financial year to reflect the new directorate structure. Detailed monthly monitoring is undertaken to ensure costs and income are accurate and up to date, and to enable effective management control and reporting. The directors and their management teams, supported by the finance team, are closely analysing base budgets to inform forecasts for the year.

7.4 The forecast for 2020/21 has been extremely challenging and volatile through the impact of COVID on service costs and income. The budget is closely monitored, with updated forecasts reported to the SMT Performance Board monthly, and to Committee quarterly. An overspend is forecast for the year, however this has reduced since the initial forecasts at the beginning of the year. Work undertaken to ensure flexibility in reserves through the financial strategy review means the Council is well placed to mitigate in year pressures.

7.5 The projected position in the medium term financial plan is more challenging, primarily due to the expected reduction in business rates and new homes bonus funding, at the same time as service priorities and cost inflation is projected to increase service budget requirements. The Budget Gap has been softened in the near term through planned use of reserves in 2021/22 and 2022/23 in the MTFP, enabled by the financial strategy. However there will be pressure to increase income further, and deliver modern efficient services and sharing of services, and reduce costs in order to ensure the projected budget gap is addressed.

8 The Current Financial Position (Balance Sheet)

8.1 The Balance Sheet shows the value at the end of the financial year of the Council's assets and liabilities. The net assets (assets less liabilities) are matched by reserves held. For 2019/20 accounts, the final Balance Sheet position as at 31 March 2020 shows the Council had net assets of £256.4m. One of the main components within long term liabilities is the pension scheme net liabilities which currently stand at £111.912m, and will reduced over the long term through deficit reduction payments. The other main

component relates to external borrowing of £75.601m, which relates entirely to the Housing Revenue Account.

Table 2 – Summary Balance Sheet as at 31 March 2020

	£000
Non-current assets (e.g. land and property, plant, equipment, vehicles)	448.3
Net current assets (debtors, stock and cash less short term creditors and liabilities)	-4.1
Long term liabilities and provisions	-187.8
Net Assets	**256.4**
Usable reserves	60.5
Unusable reserves	195.9
Total Reserves	**256.4**

8.2 Included within the net current assets is cash and short term investments totalling £33.717m. The balance provides an appropriate level of liquidity to meet short term cash flow requirements.

9 Governance Arrangements

9.1 The Council operates within a governance framework very similar to its predecessors. A new senior management structure and leadership team has been established during the year. The political leadership was created following local elections in May 2019.

9.2 The formation of the new Council was one of the outcomes of the transformation programme undertaken by the predecessor Councils, who operated a shared management and workforce. The organisation was fundamentally redesigned through transformation, and further realignment of structures has evolved during the last financial year.

9.3 The Annual Governance Statement (AGS) has concluded the Council's governance arrangements are effective, and whilst there has been a strong focus on stabilising and improving services the AGS contains an action plan identifying further plans for improvement during 2020/21. Some weaknesses in the control environment have been identified through the audit plan, reflecting disruption in workforce and business processes particularly in the first half of 2019/20, and action has been taken and is continuing to manage and mitigate these.

10 The External Regulatory and Control Environment

10.1 As a principal local authority councils have to operate within a highly legislated and controlled environment. An example of this is the requirement for a balanced budget each year combined with the legal requirement for Council to have regard to consideration of such matters as the robustness of budget estimates and the adequacy of reserves. In addition to the legal framework and Central Government control there are other factors such as the role undertaken by the External Auditor as well as the statutory requirement in some cases for compliance with best practice and guidance published by CIPFA and other relevant bodies.

11 Emerging Risks

COVID and Economic Recession

11.1 The Budget for 2020/21 was before any significant impact of COVID had emerged.

COVID has had a significant impact this year, with the Council incurring additional costs to support local communities and business, as well as a large reduction in income particularly during the lockdown period. The Council has also reprioritised reserves to support economic recovery initiatives. Overall, the additional net costs related to COVID is projected to be c£6m in 2020/21. Approximately 80% of these costs have been supported by additional funding from Government, with the balance to be met from the Council's own resources.

11.2 It is anticipated there will be ongoing financial risks due to COVID in future years. The MTFP reflects current estimates of the Council's share of 2020/21 Collection Fund losses through reductions in business rates and council tax income, which will be accounted for in 2021/22. The tax base for both business rates and council tax are also expected to be lower than pre-COVID assumptions, for example as housing growth has slowed and demand for local council tax support has grown.

11.3 The Government has supported businesses, particularly in the retail, hospitality and leisure sector, through £44.0m in grants and £28.8m in a business rates 'holiday' in 2020/21. This has provided more than £70m in financial assistance to businesses in the district during 2020/21. If the economy doesn't recover sufficiently and financial assistance is not continued next year this will place an increased risk to tax collection and increased service costs next year.

Funding

11.4 Following the one-year Spending Round in 2019, the Government delayed the Autumn Budget Statement until late 2020 and also confirmed there will be a one-year only Spending Review in 2020. It is unclear at this stage what impact this will have on the Finance Settlement for 2021/22, and clearly this adds inherent risk to funding assumptions in future years. We know the Fair Funding Review has been deferred again, and cannot make any realistic assumptions about the impact on the Council's funding at this stage. The Business Rates funding target is due to be Reset, which will remove the gain of business rates growth from the funding baseline. It is now anticipated this will also be deferred, however this has not yet been confirmed by Government at the time of writing this report. New Homes Bonus is due to be reviewed but again this has been delayed, and it is unclear whether the funding will decline as anticipated in our current MTFP. Council Tax remains the most stable form of funding, however forecasts contain risk due to rate of growth, demand for council tax support, and the continuation of annual announcements from Government on tax increase limitations.

Business Rates

11.5 Business Rates funding assumptions contain material risks due to COVID and the Reset as referred above. In addition there are two material risks to rating income. Firstly, there are two challenges currently registered with the Valuation Office to the Rateable Value for Hinkley B power station. The conclusion of these challenges was announced by the Valuation Office Agency (VOA) in December 2020, and has resulted in a major temporary reduction in the rateable value of some 90% (45% from February 2020 and a further 45% from July 2020) – reducing from RV £20.72m to RV £2.072m. The gross reduction in business rates income, which will be fully accounted for in 2020/21 accounts, could be up to £9.1m within the Collection Fund. SWTC is liable for 40% of these losses through the Business Rates Retention funding system. The Government is expected to cover 75% of SWTC funding losses through the tax loss compensation scheme being implemented to protect funding in response to COVID implications. The balance can and will need to be covered through existing provisions and reserves.

11.6 For the draft 2021/22 budget it is assumed that the RV will return to £20.72m. However, the budget also sets aside adequate funds in reserves to mitigate losses if the RV remains at £2.072m for longer than the current financial year.

11.7 In addition, the legal process regarding the NHS Foundation Trusts claims is ongoing, with the risk of a potentially large refund and ongoing reduction in business rates income. This is regarded as a possible rather than probable loss. Immediate risks are mitigated through reasonable provisions for appeals, prudent budget estimates and the Council's business rates volatility reserve.

Commercial Investment and Income Generation

11.8 Following the Council's decision to implement a new Commercial Investment Strategy in December 2019, the Council is actively growing and managing an increased investment property portfolio. This is exposed to market risk, however this is underpinned by robust governance and due diligence arrangements. Whilst this strategy diversifies the Council's income and helps to mitigate reductions in other funding streams, there is a risk of volatility e.g. through voids. Budget volatility and landlord risk is managed through reasonable budget estimates and holding prudent risk reserves.

Delivering Savings

11.9 The Council is required to achieve significant savings in order to balance the medium term financial position, through a combination of income growth and delivering efficiency through modernisation and sharing of services. The budget gap is proposed to be softened over the next 2-3 years through use of reserves as a temporary solution, however longer-term sustainable income/savings will need to be delivered in future years to balance the long term position. Having reduced costs over many years, and now growing income through investment, it will not be easy to deliver the savings needed without potentially difficult choices being made by Members on service priorities.

Unitarisation of Councils in Somerset

11.10 Government has invited submissions from local authorities in Somerset to progress the creation of one or more unitary authorities. In terms of financial risks, there will be a need for upfront funding for implementation costs, and a large scale programme of change will inevitably be a priority focus for leadership and management capacity. There is also a risk that resources are focussed on delivering structural change, reducing capacity and focus for delivering income growth and savings and/or affecting the timing of delivery.

12 S151 Officer Opinion

12.1 It is considered that, having regard to the Council's arrangement and such factors as are highlighted in this report, the Council remains a "going concern".

12.2 The Council has set a balanced budget for 2020/21, and despite the impact of COVID and economic challenges, the Council remains resilient to in year financial pressures both through additional funding provided by Government and the strength of the Council's reserves position.

12.3 The short term nature of the finance settlement from Government increases the level of uncertainty in financial planning. The Spending Review was for one year in 2019, and

will be again in 2020, which is understandable due to the scale of impact of COVID on public spending and the national economy but makes medium term financial planning difficult. Funding from business rates and new homes bonus is projected to fall sharply.

12.4 The Provisional Finance Settlement was announced by Government on 17 December 2020, and included additional one-off grant funding for 2021/22 to protect core spending power, mitigate council tax support costs and provide additional funds to support costs and losses due to COVID. This is an improvement on previous assumptions in the MTFP in respect of government funding in 2021/22.

12.5 The Council's reserves are healthy and well-placed to mitigate net spending pressures in 2020/21, and are planned to be used to support the draft budget for 2021/22 in the financial strategy. The Executive is presenting a balanced draft for 2021/22 subject to Council approval in February 2021. The longer term picture is currently projected to be more challenging and, whilst greater certainty is needed to ensure budget targets are realistic, the Council's leadership is encouraged to maintain a longer term perspective in financial planning to ensure ongoing sustainability of services.

Democratic Path:

- **Audit Governance and Standards Committee – Yes 1 February 2021**
- **Executive – No**
- **Full Council – No**

Reporting Frequency: Annually

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