

Somerset West and Taunton Council

Audit and Governance Committee – 27 September 2021

Assessment of Going Concern for 2020/21 Accounts

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 and Governance Committee of the Assistant Director Finance (S151 Officer)'s assessment of Somerset West and Taunton Council as a "going concern" for the purposes of producing the Statement of Accounts for 2020/21.

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 2020/21 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 becomes important if the financial reporting indicates that the Council is not a going concern because this would place ongoing service delivery viability as well as asset and liability valuations at risk. Such a risk is mitigated through effective governance and financial control.

4 Background and Full details of the Report

- 4.1 The S151 Officer's opinion is that the SWTC accounts for 2020/21 should be prepared on a going concern basis. The assessment and his conclusions are set out in detail in this report.
- 4.2 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) as published by the Chartered Institute of Public Finance and Accountancy (CIPFA), 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).
- 4.3 If an authority were in financial difficulty, the prospects are such 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. However, given the current circumstances of locally-led reorganisation of local government in Somerset, with transitional governance arrangements to take effect from 2022/23, any central government actions would fit in with these changes.

- 4.4 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.
- 4.5 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.
- 4.6 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 2020/21 is the second 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 Council set a balanced budget for 2020/21 and, as shown below (paragraph 6.1), the General Fund reported a significant underspend for the year whilst the Housing Revenue Account realised a very small overspend.
- 5.2 Financial risks during the year were influenced largely by COVID (see below) and continuation of bedding-in the new council, with the organisation’s management and workforce focusing on stabilisation and continuous improvement. The senior leadership team worked through a process of reshaping the organisational structure to four directorates. Staff capacity was increased as necessary to stabilise and manage service standards during the period of continued disruption, and this higher cost base has been reflected in 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 by COVID-19 and the impact of this on service costs and income for the Council. Nevertheless, the Government’s emergency funding arrangements and income loss compensation scheme have largely mitigated the additional net costs for the Council in 2020/21. Whilst additional funding was also needed from reserves in 2020/21, the Council’s Senior

Management Team (SMT) and the S151 Officer had recognised the heightened levels of risk and, as a result, prudently strengthened reserves with the further aim of supporting the budget over the next two to three years. The MTFP assumptions and forecasts were updated with reasonable estimates of the ongoing impact to on-costs and income caused by COVID; it is recognised that COVID-related risks remain and still create 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 July 2021, highlights significant medium-term financial pressures. In the short-term the financial plan looks to reduce these pressures by some use of available reserves in 2021/22 and 2022/23 along-side using predicted investment and treasury gains. The long-term financial sustainability will, ultimately, need to be ensured and delivered through establishment and design of the new Somerset unitary council, which is scheduled to be implemented on 1 April 2023.
- 5.5 The MTFP includes reasonable and prudent estimates regarding future core funding, however forecasting in respect of government grants carries a high degree of uncertainty, making medium to long-term financial planning extremely difficult. The full Comprehensive Spending Review, which was initially due in 2019 continues to be deferred with only one-year finance settlements being set by Government since.
- 5.6 Despite the uncertainties depicted above, the Council's current financial position provides a high degree of financial resilience in the short to medium-term, underpinned by healthy financial reserves. The Council has absorbed the in-year pressures from COVID and has ensured additional funding has been available to support local economic recovery. Furthermore, as the potential volatility in the local economy presents onward unpredictability to Business Rates, the Council's prudent management of general reserve balances and reserves will help to mitigate against potential losses in Business Rates funding and property investment income.
- 5.7 The Government's decision on the future of local government in Somerset was announced on 21 July 2021 and determined that there will be one single Unitary Council providing services across Somerset. Implementing any changes stemming from this will require up-front investment by Somerset West and Taunton Council (and the other affected local authorities in Somerset). The creation of the unitary council is expected to enable financial savings in the longer-term. With such a recent announcement, no assumptions for costs and income related to structural change are currently included in the MTFP, although that will be updated as further information is received on the transition process.

6 The Council's Year-End Position

General Fund

- 6.1 The financial performance in 2020/21 resulted in a net underspend of £1.250m (5.9% of Net Budget) for the year. As at 31 March 2021 the Council held a General Fund Reserve Balance of £7.915m (adequate minimum level is set at £2.4m) and held Earmarked Reserves totalling £33.768m. The Earmarked Reserves balance increased in 2020/21 by £13.258m during the year mainly due to monies set aside from the Business Rates Holiday S31 Grant (required for the Collection Fund deficit repayment in 2021/22). The adequacy of reserves, and the ongoing requirement for specified earmarked reserves,

is reviewed on a regular basis.

- 6.2 The Council has planned to use £1.16m in 2021/22 and £1m in 2022/23 of the general reserves balance to support the annual budget. In addition, a range of supplementary budgets totalling £0.961m have been approved through additional allocations from general reserves in 2021/22 (as at August 2021). The closing balance from the previous year confirms these plans are affordable, leaving £4.794m general balance currently uncommitted.

Housing Revenue Account (HRA)

- 6.3 The HRA's financial performance in 2020/21 resulted in a small net overspend of only £15k (0.01% of Gross Income Budget). As at 31 March 2021 the Council held an HRA Reserve Balance of £2.686m (adequate minimum level is set at £2.0m). In addition, there are HRA Earmarked Reserves totalling £1.108m held for specific purposes. The adequacy of reserves, and the ongoing requirement for specified earmarked reserves, is reviewed on an annual basis.

Table 1 – Revenue Reserves Summary

	General Fund		HRA		Total £m
	General £m	Earmarked £m	General £m	Earmarked £m	
Opening Balance 1 April 2020	4.522	20.586	2.701	1.648	29.457
Movement in year	3.393	13.258	-0.015	-0.540	16.096
Closing Balance 31 March 2021	7.915	33.844	2.686	1.108	45.553
Minimum Balance	2.400		2.000		

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 2021/22 was approved by Full Council in February 2021.
- 7.3 The 2020/21 budget was reorganised in the early part of the financial year to reflect changes to the Council's service directorate structure. Detailed monthly monitoring ensures costs and income are accurate and up to date and enable effective management control and reporting to continue through the financial year. The directors and their management teams, supported by the finance team, closely analyse base budgets to inform forecasts for the year and to take responsive action that may be deemed necessary.
- 7.4 As highlighted earlier in this report, both the forecast for 2020/21 and budget for 2021/22 were extremely challenging and volatile due to the impact of COVID on service costs and income. This emphasises the importance of close budget monitoring, which provides

updated monthly forecasts for the SMT Performance Board, and quarterly reports to the Council's Executive. At the time of writing this report (August 2021), projections made in the first quarter's budget monitoring forecast an overspend for the General Fund in 2021/22, although monthly monitoring shows this is trending down to be within budget. This position is adequately managed with contingencies and uncommitted reserves in place to mitigate risk.

7.5 Projecting the position in the medium-term financial plan is more challenging, primarily caused by the following issues:

- ongoing deferral of the comprehensive spending review and annual finance settlements
- ongoing impact of COVID and pace of economic recovery on service demand and volatility of key income lines such as car parking
- expected reduction in Business Rates
- effect of reforms on funding from New Homes Bonus
- service priorities and projected increase in service budget requirements
- cost inflation

7.6 As stated above, the Budget Gap has been softened in the near term through planned use of reserves in 2021/22 and 2022/23 in the MTFP, along with investment and treasury gains for 2022/23, enabled by the Council's financial strategy. As already stated, the current financial strategy assumes the long-term financial sustainability of the Council's services will be determined through the design, implementation and priorities of the successor unitary authority and the delivery of the One Somerset business case financial benefits.

8 The Current Financial Position (Balance Sheet)

8.1 The Balance Sheet as at 31 March 2021 shows the value of the Council's assets and liabilities at the end of the financial year. The net assets (assets less liabilities) are matched by reserves held. For 2020/21 accounts, the final Balance Sheet position as at 31 March 2021 shows the Council had net assets of £238.2m. One of the main components within long-term liabilities is the pension scheme net liability which currently stands at £140.2m and will reduce over the long-term through deficit reduction payments. The other main component relates to long-term external borrowing of £105.7m, which largely relates to the Housing Revenue Account. The Council's capital strategy sets out the expectation that growth in the capital financing requirement will lead to an increase in borrowing over the medium term to meet General Fund investment in capital projects, regeneration schemes and investment properties, plus planned regeneration and growth in the HRA housing stock.

Table 2 – Summary Balance Sheet as at 31 March 2021

	31Mar21 £m	31Mar20 £m
Non-current assets (e.g. land and property, plant, equipment, vehicles)	493.3	448.3
Net current assets (debtors, stock and cash less short-term creditors and liabilities)	-4.9	-4.1
Long-term liabilities and provisions	-250.2	-187.8
Net Assets	-238.2	256.4

Usable reserves	85.6	59.9
Unusable reserves	152.6	196.5
Total Reserves	238.2	256.4

8.2 Included within the net current assets is cash and short-term investments totalling £44.895m. 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 was established at the end of 2019/20 and a supporting leadership team has been established during 2020/21 through the deletion of Heads of Function posts and the creation of Assistant Director posts. The political leadership was created following local elections, which were held 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, which operated a shared management and workforce. The organisation was fundamentally redesigned through transformation, and further realignment of structures and organisational design has evolved during the last two financial years.

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 included actions for improvement during 2020/21. Some weaknesses in the control environment have been identified through the audit plan, and action has been taken and is continuing to manage and mitigate these. Assurance over key controls has improved during 2020/21 and this will continue into 2021/22.

10 The External Regulatory and Control Environment

10.1 As a principal local authority, any English local council has to operate within a highly legislated and controlled environment. An example of this is the requirement for councils to set a balanced budget each year combined with the legal requirement for Council to have regard to such matters as the robustness of budget estimates and the adequacy of reserves. In addition to the legal framework and extensive controls imposed by Central Government, there are other regulatory factors. For example, the independent role undertaken by the External Auditor in assessing a council's financial controls, providing an opinion on a council's annual accounts, as well as reviewing governance arrangements and arrangements to ensure effective use of resources. Other regulatory factors include the statutory requirements to adopt professional codes of practice and guidance, many of which are published by CIPFA and other relevant accounting and financial bodies.

11 Evolving Risks

COVID and Economic Recession

11.1 The Budget for 2020/21 was set before any significant impact of COVID had emerged. COVID has had a significant impact, 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 also reprioritised reserves to support economic recovery initiatives. Overall, the additional net costs related to COVID amounted to £7.27m in 2020/21.

- 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 and will impact thereafter. 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 during 2020/21 providing grants through this Council amounting to approximately £76million, whilst continuing to provide support through the additional restrictions grant and test and trace scheme during 2021/22. £28.8m in a business rates 'holiday' was also provided in 2020/21 to support retail, hospitality, leisure, and early years nursery businesses. Business rates support for these sectors has continued with 100% relief provided for April to June 2021, reducing to 66% relief for the remainder of 2021/22.

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. Clearly this adds inherent risk to funding assumptions in future years. We know the Fair Funding Review has been deferred again with the timing of its implementation unclear and therefore cannot make any realistic assumptions about the impact on the Council's funding at this stage.
- 11.5 The "Reset" of Business Rates funding target – which will remove the gain of business rates growth from the funding baseline – has been deferred for both 2020/21 and 2021/22. The Government has previously indicated it is considering the implementation in some form for 2022/23 however this remains uncertain with no consultation as yet undertaken (as at August 2021). A consultation was undertaken by Government in 2021 regarding the future of New Homes Bonus, with the results awaited at the time of writing. Current MTFP assumptions that funding will reduce to nil appear to be prudent based on the proposals set out in the Consultation.
- 11.6 The Government provided additional one-off funding in 2021/22 related to COVID including £813k for service and income pressures, £225k to mitigate the Council Tax Base reduction for growth in Local Council Tax Support demand, and £996k Lower Tier Services Grant. This provides welcome additional funding support in 2021/22, however it is anticipated this is once-only funding.
- 11.7 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

- 11.8 Business Rates funding assumptions contain material risks due to COVID and the Reset,

as referred to above. In addition, the Council carries a potentially material risk in respect of business rates funding linked to Hinkley Point B nuclear power station, which represents almost 20% of the total Business Rates tax base in the district.

- 11.9 The conclusion of the Hinkley B Power Station rateable value challenges (lodged in February and July 2020) was announced by the Valuation Office Agency (VOA) in December 2020, and resulted in a major temporary reduction in the rateable value of some 90% (45% from February and a further 45% from July) – reducing from RV £20.72m to RV £2.072m. This resulted in a gross reduction in Business Rates income of £9.1m, which is fully accounted for in 2020/21 accounts.
- 11.10 SWTC is liable for 40% of these losses through the Business Rates Retention funding system. It is fortunate that, due to local authority tax income protection provided as a one-off by Government in 2020/21 to protect funding in response to COVID implications, 75% of SWTC funding losses have been mitigated through the tax loss compensation scheme being implemented. The balance of the loss has been covered through existing provisions and reserves.
- 11.11 The Hinkley Point RV returned to its full £20.72m in April 2021, and EDF has announced the power station decommissioning will commence by July 2022. The 2021/22 budget includes a significant contingency to mitigate the risk of funding losses during the year e.g. if the power station decommissioning is brought forward.

Commercial Investment and Income Generation

- 11.12 Following the Council's decision to implement a new Commercial Investment Strategy in December 2019, the Council has grown and is 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.
- 11.13 In November 2020 the government (HM Treasury) issued a response to the consultation of PWLB: future lending terms. This identified that PWLB would not be available to support commercial property purchases. Due to the identified need to support the revenue budget, the Commercial Investment Strategy has been continued and funding will be obtained from other sources. External independent advice has been obtained and a balanced approach is available. PWLB continues to be available for certain purposes despite the Council continuing to plan capital expenditure on investment property acquisitions, for example to refinance existing debt and externalise internal borrowing provided it is not connected to investment property financing.

Delivering Savings

- 11.14 The Council is required to achieve significant savings in order to balance the medium term financial position. The financial strategy and updated MTFP (July 2021) set out plans to deliver a balanced budget in both 2021/22 and 2022/23. This relies on use of one-off funds as a short term measure to protect services and support to the local community as the impact of the pandemic continues, and capacity to support the implementation of a new unitary council. Savings requirements within the financial plan

in the next 12-24 months are not material in this context.

- 11.15 Savings plans will need to be delivered through the implementation of a unitary structure to ensure ongoing financial sustainability of services.

Local Government Restructuring in Somerset

- 11.16 Government invited submissions from local authorities in Somerset to progress the creation of one or more unitary authorities. The decision to progress one unitary authority was confirmed in late July 2021. 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 focused on delivering structural change, thereby 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 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 again in 2020, which is understandable initially due to Brexit and subsequently due to the scale of impact of COVID on public spending and the national economy, but it makes medium term financial planning difficult. Funding from business rates and New Homes Bonus is projected to fall sharply.
- 12.4 The Finance Settlement was announced by Government on 10 February 2021 and confirmed 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 was an improvement on previous assumptions in the MTFP in respect of government funding in 2021/22.
- 12.5 The Council's reserves are currently healthy enabling planned support to the budget and adequate mitigation for significant financial risks.
- 12.6 The Council approved a balanced budget for 2021/22 in February 2021. The Council has also planned for a balanced budget for 2022/23 within its Financial Strategy subject to the completion of the annual budget and service planning processes. The longer-term picture is currently projected to be more challenging with a potentially significant structural deficit that must be tackled in the medium term, resulting from an expected fall in Business Rates and New Homes Bonus funding. Implementation of local government restructuring in Somerset, resulting in a new unitary authority plans to deliver significant financial savings which, if delivered on a timely basis, should contribute to addressing long term financial sustainability.

Democratic Path:

- **Audit and Governance Committee – Yes 27 September 2021**
- **Executive – No**
- **Full Council – No**

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