Report Number: SWT 75/22

Somerset West and Taunton Council

Audit and Governance Committee – 13 June 2022

Assessment of Going Concern for 2021/22 Accounts

This matter is the responsibility of Councillor Allen, Communications and Corporate Resources

Report Authors: Paul Fitzgerald, Assistant Director – Finance (Section151 Officer)
John Dyson, Corporate Finance Manager

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 2021/22.

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 2021/22 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 at risk both the ongoing viability of service delivery as well as the valuations of assets and liabilities. Such a risk is mitigated through effective governance and financial control.

4 Background and Full details of the Report

4.1 Work to compile the draft Statement of Accounts for 2021/22 is underway. As a precursor to issuing the draft accounts, it is the opinion of the Assistant Director Finance (S151 Officer) that the SWTC accounts for 2021/22 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 Accounting Code of 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 to encounter 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. As a result of this, it would not therefore be appropriate for local authority financial statements to be provided on anything other than a going concern basis.

4.4 The reorganisation of the five councils in Somerset into one new unitary authority Somerset Council follows consideration by both Houses of Parliament and the Secretary of State has made the Somerset Structural Changes Order 2022. This paves the way for the new Somerset Council to be established on 1 April 2023 and transfers responsibility to the new council for the continuity of locally provided public services. The Code is clear that transfers of services under combinations of public sector bodies, such as the Somerset reorganisation, do not negate the presumption of going concern. Moreover, the services currently provided by both the County and District Councils will be continued under the management of the Unitary Council from the point of transfer.

4.5 Therefore, in accordance with the Code, the Statement of Accounts are to be prepared on the assumption that the Council will continue to operate in the foreseeable future and that it will continue to do so within the current and anticipated future 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 The Council set a balanced budget for 2021/22 and, at the time of writing this report, the S151 Officer expects to report the Council has operated within budget and will report an underspend to be transferred to General Fund reserves, and a small surplus in the Housing Revenue Account. These projected revenue outcomes are reported here ahead of completing the financial Statement of Accounts for 2021/22 and carry a likelihood of movement upon completion of the draft accounts at the end of June 2022.

5.2 Financial risks during the 2021/22 financial year were influenced largely by the following fundamental factors:

- The practical impact of COVID for the Council, local businesses, and the community
- Completion of the Council’s objectives relating to generating income from Commercial Property Investments to preserve the level and quality of services
- The UK Economic challenges, including recent substantial increases in inflation and interest rate rises
- Continuation of bedding-in the new council following integration in 2019
- Preparation towards the new Somerset unitary council.

5.3 The COVID-19 global pandemic continues to have a significant influence over the work of the Council and its resources. The most significantly damaging COVID-related impact on the Council's resources has been from a reduction in parking income with parking demand far below pre-COVID levels. The timing of any recovery to those levels cannot yet be determined. The projection is for an adverse variance of £1.6million below the 2021/22 budget. This sum includes a cushioning to some degree by compensation from government COVID grant allowances for the first quarter of the financial year.

5.4 The Government's emergency funding arrangements and income loss compensation scheme have largely mitigated the additional impact of COVID on net costs for the Council. Whilst the onset of COVID had resulted in a reduction in reserves in 2020/21 and 2021/22, the Council's Senior Management Team (SMT) and the S151 Officer had recognised the heightened levels of risk early on and prudently managed reserves with the aim of supporting future budgets for the delivery of services. During the heightened pandemic period, updates to the Council's Medium Term Financial Plan (MTFP) forecasts and assumptions have recognised the ongoing impact to on-costs and income caused by COVID as well as the risks placed on the Council's resources and normal service delivery.

5.5 The Council's latest Budget Plans for 2022/23 and the combined Medium Term Financial Plan were agreed by Full Council in February 2022. These Plans highlighted in detail the financial pressures and risks that lie ahead, along with uncertainties facing the Council in quantifying the true extent of funding and resources under the new Somerset Unitary Council. In the short-term the financial plan looks to reduce these pressures by some continued use of available reserves, taking advantage of new income streams from commercial property investments and benefitting from investment and treasury gains and containment of costs associated with capital financing. The long-term financial sustainability will, ultimately, need to be ensured by the newly-elected Council and delivered through the design and establishment of the new Somerset Unitary Council structure.

5.6 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 absence of the Government's finance settlement for 2023/24 and beyond produces continued uncertainty upon which to base future funding assumptions.

5.7 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 still-healthy financial reserves. Through continued vigilance, the Council has continued to absorb the pressures from COVID and has ensured funding has been available to support local economic recovery. Looking out towards the local business community, the potential volatility in the local economy presents onward unpredictability to Business Rates, so the Council's prudent management of general reserve balances and earmarked reserves will also help to mitigate against potential losses in Business Rates funding. In addition, imposing stringent controls to protect the Council's dependence on property investment income through carefully managed development of its property portfolio underpinned by prudent earmarked risk reserves have further preserved the Council's financial resilience.

5.8 The economic challenges that have arisen from a range of national and international drivers have been closely monitored and responded to. A combination of careful budget management at operational level, government constraints on public sector salary increases and carefully managed borrowing and investment activities have all served to protect the Council from substantial financial disadvantage.

5.9 Planning and preparations for the local government reorganisation of Councils in Somerset have devised a scheme to share the implementation costs for the creation of the new authority, which includes a contingency sum for unforeseen cost variations.

5.10 In addition, budget provision has been made to meet the anticipated need for additional capacity and backfill in key areas of activity, including both forward-facing services and support services. The aim is to keep costs to a minimum with most transitional work delivered within existing management and staff resources through prioritisation of activity. Full details are set out in the February budget and MTFP report.

6 The Council's Year-End Position

General Fund

6.1 The financial outturn position is due to be reported to the Executive in July 2022. Ahead of both this and of completion of the draft Statement of Accounts, the S151 Officer anticipates the General Fund underspend to exceed £2million with the General Reserves year-end balance exceeding £7million. This is comfortably above the adequate minimum reserves benchmark of £2.4million and provides sufficient funds to manage known commitments in 2022/23 and to maintain strong financial resilience for all but extreme unforeseen financial risks.

6.2 Balances on Earmarked Reserves as at 31 March 2022 are anticipated to comprise a total of approximately £28million (£33.8million as at 31 March 2021). The anticipated reduction in Earmarked Reserves balances in 2021/22 by nearly £6million is substantially due to the application and repayment of government COVID grant monies and release of a budget risk contingency that is no longer required. The adequacy of reserves, and the ongoing requirement for specified earmarked reserves, is reviewed on a regular basis.

Housing Revenue Account (HRA)

6.3 As noted above the S151 Officer anticipates reporting nearly break-even position against the 2021/22 budget for the HRA, with a small surplus to return to HRA general balances.

6.4 The HRA balance as at 31 March 2022 is anticipated to stand at £3.4million (£2.7million as at 31 March 2021), which includes earmarked reserves movements. Thus, the HRA balance remains above the minimum balance for financial resilience (£2.0million). Close control of costs and management of financial risks continues to be important in the year ahead to ensure adequate reserves are maintained. The longer-term position for the HRA is expected to improve as identified in the 30-Year Business Plan.

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 longer-term assessment (currently three years forward) 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 2022/23 was approved by Full Council in February 2022 and was supported by the S151 Officer's professional opinion regarding the robustness of the budget and adequacy of reserves.

7.3 The MTFP is projected forward to 2023/24 to provide an indicative position based on extrapolation of costs and income under the current district council structure. In practice through the combination of the councils into the Somerset unitary authority in April 2023, a new MTFP for the new authority will need to be prepared during the coming months to establish new forecasts for the new single entity. Whilst SWTC's MTFP projects an indicative budget gap in 2023/24 of approximately £5m this will be incorporated and updated within Somerset Council's MTFP to be considered through the new financial strategy and 2023/24 budget process. The SWTC projected gap potentially includes pessimistic funding forecasts, however this may be countered by rising inflationary pressures on service delivery costs.

7.4 Despite the projected financial challenges, LGR provides an opportunity to reduce costs in the short to medium term across local government in Somerset, which will contribute to ongoing financial sustainability of services.

7.5 Challenges presented by events highlighted earlier in this report, such as the pandemic, the economy, funding streams and variations in service demand, emphasise the importance of close budget monitoring. Detailed monthly budget monitoring provides updated forecasts for the Senior Management Team Performance Board, and quarterly corporate level reports are presented to the Council's Executive. These routines ensure 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.

8 The Current Financial Position (Balance Sheet)

8.1 The Balance Sheet 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. As at 31 March 2021, the final Balance Sheet position as at 31 March 2021 shows the Council had net assets of £248m at the start of 2021/22. This is matched by £86m of usable revenue and capital reserves plus £162m of unusable reserves (such as the pensions reserve and capital adjustment account).

8.2 At the time of writing this report the final balance sheet position as at 31 March 2022 is in preparation. The final position will be formally reported to Audit and Governance Committee in September, but the Draft Statement of Accounts is on track to be published by the end of June. Material changes to the overall balance sheet position are expected to include:

- An increase in non-current assets through capital asset acquisitions and completions during 2021/22 per the General Fund and HRA capital programmes.
- An increase in long-term liabilities and provisions through the Council's planned increase in borrowing to support capital expenditure, and potentially through the

annual valuation of pension fund liabilities.
- Planned use of earmarked reserves during the year.

8.3 One of the main components within long-term liabilities is the pension scheme net liability which stood at £140.2m on 31 March 2021. This will reduce over the long-term through deficit reduction payments which are built into medium term financial projections to be met from income / funding received each year. The other main component relates to long-term external borrowing which largely relates to the Housing Revenue Account and the Council's strategy of investing in property for yield with acquisitions completed between August 2020 and December 2021.

8.4 HRA borrowing is to be funded through housing rent income with affordable debt repayment built into the Business Plan and Budget. Investment property acquisition has been funded largely through borrowing, plus some up-front revenue funding in 2021/22. The residual borrowing requirement in respect of investment properties is projected by March 2023 to be 92.5% of the £99m initial capital invested. This will reduce year-on-year through annual Minimum Revenue Provision of circa £2m, which is funded through rental income. Budget risk is underwritten by prudent earmarked investment risk reserves.

9 Governance Arrangements

9.1 In its current structure, the Council operates within a governance framework commonly used in local government, the Leader and Cabinet model. The Executive composition, committees, terms of reference, committee allocation and appointments to committees and outside bodies were reviewed at the meeting of Full Council on 24 May 2022. Following local elections to Somerset County Council, held on 6 May 2022, those elected as county councillors will take responsibility for all current County Council services for their first year and oversee the local government reorganisation to establish the single unitary Somerset Council on 1 April 2023 and then continue as councillors of the unitary authority for a four year term. District councils will remain until 31 March 2023 and the councillors serving on them will continue in their roles until that date. Meanwhile, the Council's current Senior Management Team comprises the Chief Executive and four Director posts. The S151 Officer and Monitoring Officer attend SMT meetings as required. Assistant Directors oversee day-to-day operations within each Directorate.

9.2 The Annual Governance Statement (AGS), which is reported separately to the Audit and Governance Committee, provides a comprehensive overview of governance arrangements and associated action plan. (The draft AGS is scheduled to appear as a separate item on this meeting of the Committee on 13 June 2022.)

10 The External Regulatory and Control Environment

10.1 As a principal local authority, any English local council operates 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 The Economy

11.1 As reported above, COVID continues to impact on local government services and its finances. Financial risks have been carefully considered within financial planning assumptions and forecasts, with prudent estimates built into service budgets.

11.2 More recently, we have seen a sharp increase in inflationary cost pressures, which is exacerbated through Russia's invasion of Ukraine. This will drive up the cost of service delivery and presents a risk to the 2022/23 budget performance. Similarly, supply chain issues may increase costs but slow down spending in the short-term. The Bank of England has increased interest rates, most recently in May 2022 to 1%. It is more likely than not that interest rates will increase further in 2022. This presents risks in terms of borrowing costs however we have largely mitigated this through effective treasury management and prudent budgeting.

11.3 Pressures on household income increase the risk of lower tax collection rates and higher demand for local services and financial assistance such as local council tax support. Such events can lead to increased costs and reduced income. Again, prudent budgeting and reserves help to mitigate any short-term impact for SWTC.

Funding

11.4 The Government announced a 3-Year Spending Review in 2021 but only provided a one-year Finance Settlement for 2022/23. This provides clarity for 2022/23 but continues to leave significant uncertainty for financial planning assumptions for subsequent years.

11.5 For SWTC we have reduced our core business rates funding budget to the safety net with the expected imminent decommissioning of Hinkley B power station. Although this has significantly reduced funding it also reduces adverse risk of funding volatility through this income stream.

11.6 The planned review of local government funding continues to be deferred, as does the related reset of baseline funding. The Government again provided 'one-off' grant allocations for 2022/23 which is helpful in the short term but does not support longer term financial planning. Through the LGR Programme, S151 Officers will work with Government officials to consider the implications of the transition to a unitary council on baseline funding and grants.

11.7 A consultation was undertaken by Government in early 2021 regarding the future of New Homes Bonus. Despite the consultation closing some time ago the Government has yet to publish its response. We have assumed nil grant in 2023/24 within the MTFP pending clarity on the future of this funding source.

11.8 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

11.9 Business Rates funding assumptions contain material risks due to COVID and the anticipated 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. However, this risk is largely mitigated in 2022/23 with income budget reduced to reflect the imminent decommissioning of Hinkley B.

11.10 SWTC is liable for 40% of these losses through the Business Rates Retention funding system. However, with the closure of Hinkley B the risk of such losses is now largely mitigated through the Safety Net provision which is funded by central government within the Business Rates Retention system. Equally the benefit of growth is only positive for SWT when net rating income is above the safety net.

Commercial Investment and Income Generation

11.11 Following the Council's decision to implement a new Commercial Investment Strategy in December 2019, the Council has invested £99m in property in order to provide income to fund local services and mitigate cuts in central government funding. This strategy is exposed to market risk; however, it 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.

11.12 HM Treasury has imposed restrictions on borrowing from the Public Works Loan Board (PWLB) where an authority invests in assets primarily for yield. As such, SWTC will not be able to borrow from the PWLB in 2022/23 other than for treasury management purposes which may include refinancing of existing loans and internal borrowing not related to investments for yield. The implications for SWTC are expected to be minimal with facilities already secured to meet current debt requirements and readily available access to alternative lending sources.

12 Section 151 Officer Opinion

12.1 It is considered that, having regard to the Council's arrangement and such factors as are highlighted in this report, it is my opinion that the Council remains a "going concern" and that it is appropriate to prepare the 2021/22 accounts on this basis.

12.2 The Council set a balanced budget for 2021/22, and despite the impact of COVID and economic challenges, the Council remains resilient to in-year financial pressures with prudent budgeting 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, however prudent and potentially pessimistic assumptions are included in the MTFP in this regard.

12.4 The Council's reserves are currently healthy enabling planned support to the budget and adequate mitigation for significant financial risks. General Reserves are currently projected to remain comfortably above the minimum adequate level and earmarked reserves contain further contingencies for the more-significant financial risks.

12.5 The Council also approved a balanced budget for 2022/23 in February 2022. The longer-term picture is currently projected to be more challenging with a potentially significant structural deficit in 2023/24. This contains cautious estimates in relation to funding but is still expected to require action to address the underlying gap between income and projected costs. Planning for this will need to be undertaken alongside the implementation of the unitary council in Somerset, for which the business case anticipates savings of £18.5m can be achieved.

Democratic Path:

- **Audit and Governance Committee – Yes 13 June 2022**
- **Executive – No**
- **Full Council – No**

Reporting Frequency: Annually

Contact Officer

Name	Paul Fitzgerald
Direct Dial	01823 217557
Email	S151@somersetwestandtaunton.gov.uk