Agenda Item

FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

7 December 2021

Report of the Director of Finance & ICT

Assessment of Going Concern Status

1. Divisions Affected

1.1 County-wide.

2. Key Decision

2.1 This is not a Key Decision.

3. Purpose

3.1 To inform Audit Committee of the Director of Finance & ICT's assessment, as Section 151 Officer, of the Council's status as a 'going concern' for the purpose of producing its Statement of Accounts for 2020-21.

4. Information and Analysis

4.1 The concept of '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 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. The Government has actually offered support to a number of local authorities over the last 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 Where it is assessed that an entity is not a going concern, particular care would be needed in respect of 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 Given the significant reduction in funding for local government in recent years and the continuing threat that Covid-19 poses to the ongoing viability of one or more councils as a consequence, last year external auditors placed a greater emphasis on local authorities undertaking and formalising an assessment of the going concern basis on which they prepare their financial statements.

4.5 As with all principal local authorities, the Council is required to compile its Statement of Accounts in accordance with the Code of Practice on Local Authority Accounting for 2020-21 (the Code) published by the Chartered Institute of Public Finance and Accountancy (CIPFA). In accordance with the Code the Council's Statement of Accounts are prepared assuming that the Council will continue to operate in the foreseeable future and that it is 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.

4.6 The main factors which underpin a going concern assessment are the:

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

4.7 Each of these factors is considered in more detail below.

Year-End Financial Position

4.8 The following review is based on the Council's pre-audit Statement of Accounts published in July 2021.

Revenue

4.9 The 2020-21 revenue outturn position was a net underspend of £27.630m (4.76% of net budget). This result must be viewed in context that this was an unusual year during which the Council received nearly £14m of government funding to meet the cost of all hospital discharges for periods during the Covid-19 pandemic; costs which would ordinarily have been met from the Council's own budget. There is also some evidence to suggest that demand for placements for children who are in care slowed during the early periods of lockdown, dampening associated increases in costs. Several amounts of contingency funding and one-off funding remained unused as planned initiatives could not proceed due to the pandemic, however, the ability to achieve some planned savings was also curtailed. By comparison, the 2019-20 revenue outturn position was a net underspend of £3.857m (0.71% of net budget). As at 31 March 2021 the Council's General Reserve balance was £77.665m (£53.547m at 31 March 2020) and its earmarked reserves balance was £260.503m (£229.135m at 31 March 2020).

4.10 At its meeting of 29 July 2021, Cabinet agreed to make the following allocations from the £27.630m 2020-21 underspend:

- £14.000m to an earmarked reserve as a contingency against potential funding losses during the Covid-19 recovery period, to support the Council in the short and medium-term in responding to unforeseen costs resulting from the Covid-19 pandemic.
- £9.000m to the Budget Management earmarked reserve to support the Council in setting a balanced budget in future years, through the use of one-off funding to support services.
- £2.246m to provide for specific commitments and to provide portfolios with flexibility in meeting budget pressures and reduction targets.

4.11 After the allocations above, this leaves the balance on the General Reserve at £52.419m. This balance is 9.5% of the Council's net expenditure (£553.375m) in 2020-21. In the Audit Commission's 'Striking a Balance' report published in 2012, the majority of chief finance officers at the national level regarded an amount of between 3% and 5% of a council's net spending as a prudent level for risk- based reserves.

4.12 The adequacy of reserves is reviewed on a regular basis and the ongoing requirement for specified earmarked reserves is reviewed on an annual basis.

Capital

4.13 Capital expenditure in 2020-21 was £91.062m (£103.249m in 2019-20). The Council has not entered into any long-term debt since September 2010. Where grants or capital receipts were not available, the Council's strategy has been to fund capital investment by using available cash balances, thereby reducing the cost of interest charges. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). As at 31 March 2021 the Council's Loans Capital Financing Requirement was £461.134m (£456.291m at 31 March 2020) of which £360.899m was funded from external sources (£329.974m at 31 March 2020) and £100.235m utilised available cash balances (£126.317m at 31 March 2020), therefore the Council's actual borrowing level remains well below its underlying need to borrow.

Table 1: Capital Financing, Borrowing and Investments Summary

	31 Mar 20 £m	**31 Mar 21 £m**
General Fund CFR	525.169	525.679
Less: Other debt liabilities*	(68.878)	(64.545)
Loans CFR	**456.291**	**461.134**
Less: External borrowing**	(329.974)	(360.899)
Internal borrowing	**126.317**	**100.235**
Less: Usable reserves***	(305.525)	(395.100)
Less: Working capital	(47.672)	(43.421)
New borrowing (or Treasury investments)	**(226.880)**	**(338.286)**

*Leases, PFI liabilities and transferred debt that form part of the Council's total debt
**Shows only loans to which the Council is committed and excludes optional refinancing
***Excludes the earmarked reserve created from loan modification gains

Balance Sheet

4.14 The Balance Sheet shows the value as at the Balance Sheet date of the assets and liabilities recognised by the Council. The Council's net assets (assets less liabilities) are matched by the reserves held.

Table 2: Summary Balance Sheet

	31 Mar 20 £m	31 Mar 21 £m
Non-Current Assets	1,890.095	1,794.658
Net Current Assets (e.g. debtors, inventories and cash, short term creditors and liabilities)	34.671	75.772
Pensions Liabilities	(706.324)	(1,084.181)
Other Long-Term Liabilities and Provisions	(319.192)	(319.067)
Net Assets	**899.250**	**467.182**
Usable Reserves	331.648	420.353
Unusable Reserves	567.602	46.829
Total Reserves	**899.250**	**467.182**

4.15 The following trends are reflected in the Balance Sheet from the position as at 31 March 2020 to the position as at 31 March 2021:

- net assets have decreased from £899.250m to £467.182m (a year-on-year decrease of £432.068m);
- non-currents assets have decreased from £1,890.095m to £1,794.658m (a year-on-year decrease of £95.437m);
- non-current liabilities have increased from £1,025.516m to £1,403.248m (a year-on-year increase of £377.732m);
- the debt ratio has increased from 0.58 to 0.78.

4.16 The debt ratio is the proportion of liabilities to assets. It is a measure of an entity's ability to service its debts by selling its assets if it had to. A larger ratio indicates that more assets are being paid for by borrowed money, which can suggest less stability. At 0.78, the Council's debt ratio remains below 1 and is therefore not a cause for concern.

4.17 The large increase in non-current liabilities and corresponding decrease in net assets on 2020-21 is due to a change in the financial assumptions used to estimate the net pension liability. These assumptions include:

- The pension increase rate (CPI) increasing to 2.85% at 31 March 2021 (1.90% at 31 March 2020).
- The salary increase rate increasing to 3.55% at 31 March 2021 (2.60% at 31 March 2020).

- The discount (investment return) rate decreasing to 2.00% at 31 March 2021 (2.30% at 31 March 2020).

4.18 The net pension liability reported from one financial year to the next can be volatile and is extremely sensitive to changes in the underlying assumptions. The implications of changes in this amount can only be properly considered in the medium to long-term. As a participating employer in the Derbyshire Pension Fund, the Council reviews and adjusts its employer contributions every three years under advice from the actuary. This provides confidence that the Council's obligations remain sustainable by ensuring that rates are adequate to meet the cost of future service of active Fund members and that additional cash amounts address past service deficit.

4.19 The Council's balance sheet at 31 March 2021 remains robust. Factors contributing to this assessment include:

- a review of debts owed to the Council;
- the adequacy of risk-assessed allowances for doubtful debts;
- the range of earmarked reserves set aside to help manage expenditure;
- an adequate general reserve which includes a risk-assessed working balance to meet unforeseen expenditure.

4.20 A financial overview that includes reference to the Council's balance sheet is included as part of the Narrative Report in the Statement of Accounts.

Cash Flow

4.21 The Council maintains short and long term cash flow projections, and manages its cash, investments and borrowing in line with the Council's approved Treasury Management Strategy. As at 31 March 2021, the Council had external borrowing commitments of £360.899m (£329.974m at 31 March 2020) and held £338.286m in treasury investments and cash (£226.880m at 31 March 2020).

Projected Financial Position

Covid-19 Costs and Grant Compensation

4.22 The forecast cost to the Council of Covid-19 is around £15m for 2021-22, which includes the impact of planned savings for the year being delayed. This is the cost which is not expected to be funded from a specific grant allocation such as the Adult Social Care Infection Control Fund. Covid-19 emergency grant funding of £15.337m has been received from the Government in 2021-22 and £11.248m of funding from these grants received in 2020-21 has been brought forwards in an earmarked reserve. Therefore, the Council anticipates that it has sufficient funding to meet the expenditure incurred based on its current forecasts.

4.23 The estimated gross loss of sales, fees and charges income is estimated to be £4m in 2021-22. Where losses are more than 5% of a council's planned income from sales, fees and charges, the Ministry of Housing, Communities and Local Government (MHCLG) has announced it will cover 75p for every pound of irrecoverable losses for the period 1 April 2021 to 30 June 2021. Therefore, up to £2.7m of grant could be claimable under this scheme, although the actual amount is likely to be lower because compensation is based on a net loss, i.e. it is only the residual loss where related expenditure has also reduced.

Social Care Costs

4.24 Pressures across both Children's and Adult Social Care (ASC) continue to far outstrip increases in additional funding announced in the Spending Review (SR) 2019 and SR 2020 and costs are likely to continue to increase significantly.

4.25 Forecasts as at Quarter 2 (September 2021) suggest there may be overspends across the two social care portfolios of around £12m in 2021-22. These are offset by around £8m set-aside in the Council's Contingency and Risk Management budgets and £4m of additional non-ring-fenced grants announced after the budget was set (former Independent Living Fund and Extended Rights to Home to School Transport grants).

Council Tax and Business Rates Income

4.26 Local tax income is collected by billing authorities and paid into local Council Tax and Business Rates 'collection funds'. Where there is a shortfall in tax receipts (compared to expected levels), this leads to a deficit on the collection fund. The impacts of Covid-19 have resulted in large collection fund deficits in 2020-21; the Council's share of these deficits for 2020-21 was around £7.1m for Business Rates and £2.4m for Council Tax. Billing and major precepting authorities are usually required to meet their share of any deficit during the following financial year. However, the Government is allowing repayments to meet collection fund deficits accrued in 2020-21 to be phased over a three-year period to ease immediate pressures on budgets. The phasing of the Business Rates collection fund deficit was £6.9m in 2021-22 and will be £0.1m in each of 2022-23 and 2023-24 (most billing authority Business Rates deficits were not spread). The phasing of the Council

Tax collection fund deficit was £0.2m in 2021-22 (net of two billing authorities' collection fund surpluses) and will be £1.1m in each of 2022-23 and 2023-24.

4.27 Council Tax income is expected to be affected negatively by the pandemic. The taxbase increased by only 0.36% in 2021-22, impacted by an increase in the number of residents claiming Council Tax benefits. Previous years have seen increases in the taxbase of 1.71%, 1.17% and 1.47%. A gradual recovery of taxbase increases is now anticipated, with a current forecast increase of 1.00% in 2022-23 and annual increases of 1.50% thereafter.

4.28 It is clear that Government has a definite expectation that part of the additional pressures in adult care will be funded by levying additional ASC Precept. Therefore, the Council has accepted the need to levy the ASC Precept at 1% for 2021-22 and also to increase basic Council Tax by 1.5%, in recognition of ASC pressures and the significant increase in general budget pressures the Council is experiencing. This then gives the Council the option of levying the remaining 2% ASC Precept in 2022-23, in addition to any increases permitted by the 2022-23 Referendum Principles, in the expectation that the worst effects of the Covid-19 pandemic will be over and recovery will have begun. The Spending Review 2021 announcement on 27 October 2021 assumes that over the three year period of the Spending Review, from 2022-23 on, there is a 2% per year Council Tax general increase, with a further 1% per year of Adult Social Care precept for social care authorities, on top of any Adult Social Care Precept carried forward from 2021-22 to 2022-23.

4.29 The Council is being supported in 2021-22 with £6m of funding from the Local Council Tax Support scheme which is a non-ring-fenced grant aimed to compensate for lower than expected taxbase increases. In addition to this the Local Tax Income Guarantee Scheme promises to guarantee that the Council will be compensated for 75% of losses in Council Tax and Business Rates income which prove irrecoverable.

Five Year Financial Plan

4.30 The Council's Five Year Financial Plan (FYFP) is updated annually and reflects an assessment of the Council's spending plans in the current and next four financial years. It includes the ongoing implications of approved budgets, service levels, costs of the capital programme and costs of servicing its debts and returns from its investments.

4.31 The Council's Plan for the period 2021-22 to 2025-26 was last updated in and reported to Council as part of the Revenue Budget Report in

February 2021. Whilst this was a comprehensive review, it was prepared in the context of considerable uncertainty surrounding the future costs, effects on income and levels of Government grant support relating to Covid-19.

4.32 The latest forecast assumes that around £16.136m of one-off funding from reserves will be required to support the 2021-22 revenue budget. However, this is reliant on £13.291m of budget savings being achieved. As the response to Covid-19 has impacted on the ability to implement savings plans, the delivery of some savings is subject to significant slippage. Around £10m of savings are expected to be achieved in the year. All savings which are delayed or not delivered increases the pressure on the Council's reserves, or require alternate savings to be found by services. Furthermore, an additional £60m of savings are expected to be required between 2022-23 and 2025-26.

Governance Arrangements

4.33 The Council has a well-established and robust corporate governance framework. This includes the statutory elements like the post of Monitoring Officer and the Section 151 Officer in addition to the current political arrangements.

4.34 An overview of this governance framework is provided within the Annual Governance Statement (AGS) which is included in the Statement of Accounts. This includes a detailed review of the effectiveness of the Council's governance arrangements. Whilst it is not possible to provide absolute assurance, the review process as outlined in the AGS does conclude that the existing arrangements remain fit for purposes and help provide reasonable assurance of their effectiveness.

4.35 The impact of Covid-19 is having an effect on financial sustainability and this has been considered as part of this going concern assessment. That aside, there are no further material issues identified through the AGS process that may significantly impact on management consideration of the Council's Financial Resilience and therefore on its going concern status.

4.36 The Council is working with the Local Resilience Forum and a range of partners locally and regionally on a Covid-19 recovery programme.

External Regulatory and Control Environment

4.37 As a principal local authority, the Council has to operate within a highly legislated and controlled environment. An example of this is the requirement to set a balanced budget each year, combined with the legal requirement for the 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. For example, the Council has measured itself against the principles set out in CIPFA's Financial Management Code and is confident that it is achieving these in all substantive areas.

4.38 Against this backdrop it is considered unlikely that a local authority would be 'allowed to fail', with the likelihood being that when faced with such a scenario, that central government would intervene, supported by organisations such as the Local Government Association, to bring about the required improvements or maintain service delivery.

4.39 Given the severity of this pandemic on the country's finances, it would be complacent to rely on Government intervention. However, the Department of Housing, Levelling Up and Communities (DHLUC) has urged any authority that is left with unmanageable pressures and may be concerned about their future financial position to contact DHLUC with immediate effect.

4.40 The Council has deployable resources and assets at its disposal in the short to medium term. The greatest risk to its financial sustainability in the longer term is from not achieving substantial budget savings, demand pressures on looked after children, the effect of demographic growth on Adult Social Care costs and concern over inflation. The Covid-19 pandemic has delivered a significant economic shock. In October 2021 annual UK Consumer Price Inflation (CPI) reached 4.2%, largely due to surging demand and supply chain problems. However, labour market data shows that in the three months to September 2021 the unemployment rate fell to 4.3%. Growth in average regular pay was 4.9% over the period July to September 2021. The robust growth figures are partially due to measurement against a low base, following on from a decline in average pay in Spring 2020 associated with the furlough scheme. Furthermore, the Spending Review 2021 indicates that there will be support for local government over the next three years, with some level of certainty being given.

4.41 The Section 151 Officer has the power to issue a Section 114 notice if there is a significant risk that the Council will not be in a position to deliver a balanced budget by the end of the current financial year. This is an emergency situation where a response is required by legislation. The notice means that no new expenditure is permitted, with the exception of safeguarding vulnerable people and statutory services and continuing to meet existing contract obligations. There is no intention at this time to issue a Section 114 notice.

Conclusions

4.42 The Council set a balanced budget for 2021-22 and over the FYFP period in February 2021. Although Covid-19 has impacted significantly on the Council's activity and finances, it expects to have sufficient funding from specific and non-ring-fenced grants to offset any additional costs in the near term and therefore the pandemic is not expected to pose a significant risk to the Council's financial resilience in the year to 31 March 2022. Additional funding announced at the Spending Review 2021, on 27 October 2021, will help to support a balanced budget, with the caveat that the final detail will not be known until the Provisional Settlement, expected in mid-December 2021.

4.43 Although a funding shortfall is not anticipated, the Council has sufficient further reserves it can deploy in 2021-22 should it be required to do so. Any use of reserves for this purpose does, however, impact on the funding of the Council's planned improvements, delay some savings plans and require additional general reserves to be set aside in order to ensure that the balance of general reserves remains at a prudent risk-assessed level. Also, because of the Council's Treasury Management Strategy over the last decade to use internal borrowing, rather than take on new long-term external borrowing, the Council has head-room, within the scope of its powers under the Prudential Framework, to take on additional external borrowing to preserve the liquidity of its cash flow, should it need to do so.

Section 151 Officer Opinion

4.44 Having regard to the Council's arrangements and such factors as highlighted in this report, the Director of Finance & ICT as Section 151 Officer concludes that Derbyshire County Council remains a going concern and that it is appropriate that the Council's Statement of Accounts for 2020-21 have been prepared on this basis.

5 Consultation

5.1 No consultation is required.

6 Alternative Options Considered

6.1 N/A – this report notes this formal assessment of the Council's status as a 'going concern' and the conclusion that it is an appropriate basis for preparing the Council's Statement of Accounts 2020-21.

7 Implications

7.1 Appendix 1 sets out the relevant implications considered in the preparation of the report.

8 Background Papers

8.1 The following previously published documents:

- Pre-Audit Statement of Accounts 2020-21 – Audit Committee 21 September 2021
- Revenue Budget Report 2021-22 – Council 3 February 2021
- Q1 2021-22 Budget Monitoring Report – Cabinet 9 September 2021

9 Appendices

9.1 Appendix 1 – Implications.

10 Recommendation

That Audit Committee:

10.1 Notes this formal assessment of the Council's status as a 'going concern' and the conclusion that it is an appropriate basis for preparing the Council's Statement of Accounts 2020-21.

11 Reasons for Recommendation

11.1 A formal Assessment of the Council's Going Concern Status is required to allow the Statement of Accounts to be signed.

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This report has been approved by the following officers:

On behalf of: Director of Legal Services and Monitoring Officer Director of Finance and ICT	

Appendix 1

Implications

Financial

1.1 As outlined in the body of the report.

Legal

2.1 None

Human Resources

3.1 None

Information Technology

4.1 None

Equalities Impact

5.1 None

Corporate objectives and priorities for change

6.1 The Council is committed to ensuring good financial management and compliance with applicable laws and regulations.

Other (for example, Health and Safety, Environmental Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None