Public

Agenda Item No

DERBYSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

24 November 2020

Report of the Director of Finance & ICT

ASSESSMENT OF GOING CONCERN STATUS

1 Purpose of the Report

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 2019-20.

The Chairman agreed to consider this report as an urgent item as a formal Assessment of Going Concern Status is required to allow the Statement of Accounts to be signed in accordance with the Statutory Deadline.

2 Information and Analysis

Background

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 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.

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.

Given the significant reduction in funding for local government in recent years and the potential threat that Covid-19 poses to the ongoing viability of one or more councils as a consequence, external auditors are placing a greater emphasis on local authorities undertaking and formalising an assessment of the going concern basis on which they prepare their financial statements. In response this report sets out the position at Derbyshire County Council.

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 2019-20 (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.

The main factors which underpin this assessment are the:
- Council's current financial position;
- Council's projected financial position;
- Council's governance arrangements; and
- regulatory and control environment applicable to the Council as a local authority.

Each of these factors is considered in more detail below.

Year-End Financial Position

The following review is based on the Council's pre-audit Statement of Accounts published in June 2020.

<u>Revenue</u>

The 2019-20 revenue outturn position was a net underspend of £3.857m (0.71% of net budget). As at 31 March 2020 the Council's General Reserve balance was £53.547m (£64.570m at 31 March 2019) and earmarked reserves totalled £229.135m (£233.445m at 31 March 2019).

At its meeting of 31 July 2020, Cabinet agreed to allocate the £3.857m underspend to earmarked reserves, to provide for specific commitments and to provide portfolios with flexibility in meeting budget pressures and reduction targets, leaving the balance on the General Reserve at £49.690m. This balance is 9.2% of the Council's net expenditure (£539.583m) in 2019-20. 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.

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

Capital expenditure in 2019-20 was £103.249m (£101.652m in 2018-19). 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 2020 the Council's Loans Capital Financing Requirement was £456.291m (£414.068m at 31 March 2019) of which £329.974m was funded from external sources (£313.124m at 31 March 2019) and £126.317m utilised available cash balances (£100.944m at 31 March 2019), 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 19 £m	**31 Mar 20 £m**
General Fund CFR	487.050	525.169
Less: Other debt liabilities*	(72.982)	(68.878)
Loans CFR	**414.068**	**456.291**
Less: External borrowing**	(313.124)	(329.974)
Internal borrowing	**100.944**	**126.317**
Less: Usable reserves***	(338.293)	(305.525)
Less: Working capital	(36.435)	(47.672)
New borrowing (or Treasury investments)	**(273.784)**	**(226.880)**

*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

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 19 £m	**31 Mar 20 £m**
Non-Current Assets	2,012.368	1,890.095
Net Current Assets (e.g. debtors, inventories and cash, short term creditors and liabilities)	104.422	34.671
Pensions Liabilities	(935.258)	(706.324)
Other Long Term Liabilities and Provisions	(329.368)	(319.192)
Net Assets	**852.164**	**899.250**
Usable Reserves	366.732	331.648
Unusable Reserves	485.432	567.602
Total Reserves	**852.164**	**899.250**

The following trends are reflected in the Balance Sheet from the position as at 31 March 2019 to the position as at 31 March 2020:

- net assets have increased from £852.164m to £899.250m (a year-on-year increase of £47.086m);
- non-currents assets have decreased from £2,012.368m to £1,890.095m (a year-on-year decrease of £122.273m);
- non-current liabilities have decreased from £1,264.626m to £1,025.516m (a year-on-year decrease of £239.110m);
- the debt ratio has decreased from 0.63 to 0.58.

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 0.58, the Council's debt ratio is well below 1 and is therefore not a cause for concern.

The Council's balance sheet at 31 March 2020 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.

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

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 2020, the Council had external borrowing commitments of £329.974m (£313.124m at 31 March 2019) and held £226.880m in treasury investments and cash (£273.784m at 31 March 2019).

Projected Financial Position

Covid-19 Costs and Grant Compensation

The forecast cost to the Council of Covid-19 is around £70m for 2020-21, which includes the impact of planned savings for the year being significantly 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. The total amount received to date from the Government in Covid-19 emergency grant funding is £41.995m. This highlights a significant funding gap which will have to be met by one-off resources if further Government support is insufficient to meet the expenditure incurred. On 12 October 2020 the Prime Minister announced an additional £1bn of funding for local authorities across England to enable them to 'protect vital services as they fight the virus'.

The estimated loss of sales, fees and charges income is estimated to be £11m in 2020-21. 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 announces it will cover 75p for every pound of irrecoverable losses for the period 1 April 2020 to 31 March 2021. Therefore, it is anticipated that around £6.5m of grant will be claimable under this scheme.

Council Tax and Business Rates Income

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. It is anticipated that the impacts of Covid-19 will result in large collection fund deficits in 2020-21; the latest assumptions are that the Council’s share of these deficits for 2020-21 could be around £4.5m for Business Rates and £10.5m 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 (2021-22 to 2023-24) to ease immediate pressures on budgets.

In the wake of the pandemic’s onset, it is now anticipated that locally retained business rates will grow at a much slower rate than previously forecast and that there will be no gain from the Derbyshire business rates pool over the next three years to 2023-24. There is also considerable uncertainty around business rates appeals. A number of businesses are using the ‘material event’ option in Valuation Office Agency (VOA) guidance to appeal against their rateable value. Successful appeals will further reduce the Council’s income from locally retained business rates.

Similarly, Council Tax income is expected to be affected negatively by the pandemic. The taxbase is now forecast to contract in 2021-22 and then grow at a reduced rate until 2023-24. There is no certainty either that an option to raise additional Council Tax income for Adult Social Care will be available from 2021-22 and onwards. Therefore, assuming also that current plans to freeze the main rate of Council Tax proceed, income from Council Tax is likely to reduce in 2021-22 and be depressed in the years following.

Five Year Financial Plan

The Council’s Five Year Financial Plan (Plan) 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.

The Council's Plan for the period 2020-21 to 2024-25 was last updated in November 2020. 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.

The latest forecast assumes that around £37.489m of one-off funding from reserves will be required to support the 2020-21 revenue budget. However, this is reliant on £18.795m of budget savings being achieved. As the response to Covid-19 has impacted on the ability to implement savings plans, the delivery of these savings is subject to significant slippage and only around half this amount is expected to be achieved in the year, therefore the pressure on reserves is likely to be higher. Furthermore, an additional £63m of savings are expected to be required between 2021-22 and 2024-25 even if there are no ongoing net costs from Covid-19 in these years.

Governance Arrangements

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.

An overview of this governance framework is provided within the Annual Governance Statement (AGS) which will be included in the post-audit 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.

The impact of Covid-19 will have an effect on financial sustainability and 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 going concern.

The Council is working with the Local Resilience Forum on Covid-19 recovery. The Council's focus is still firmly on the response activities and the Council is working with a range of partners locally and regionally on a Covid-19 recovery programme.

External Regulatory and Control Environment

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.

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.

However, given the severity of this pandemic on the country's finances, it would be complacent to rely on Government intervention. MHCLG has conceded that authorities could still be left with unmanageable pressures and may continue to be concerned about their future financial position, urging any authority that found itself in that position to contact the department with immediate effect.

Whilst the Council has deployable resources and assets at its disposal in the short to medium term, there remains a risk to its financial sustainability in the longer term from costs associated with Covid-19 and of not achieving substantial budget savings.

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. Despite the current financial pressures there is no intention at this time to issue a Section 114 notice.

Conclusions

The Council set a balanced budget for 2020-21 and over the Five Year Financial Plan period in February 2020. However, since then Covid-19 has impacted significantly on the Council's activity and finances. Covid-19 poses a significant risk to the Council's financial resilience.

It is unclear how much further Government support will be provided to cover the costs resulting from the pandemic; these costs are expected to be well in excess of the support already provided. It is encouraging that a new round of Covid-19 funding was announced on 12 October 2020, as the second wave of the pandemic is starting to escalate in severity. Although the immediate impact of losses on the collection funds (council tax and business rates) has been eased by allowing these costs to be spread over three years instead of one, there has been no commitment to reimburse councils for these losses. It is also apparent that Government will only provide compensation for some of the Council's lost income from fees and charges. Consideration will be required as to how the Council can react to replace these income streams if they fail to recover to pre-Covid-19 levels.

Despite these risks, the Council has sufficient reserves it can deploy in 2020-21 to meet the anticipated funding shortfall, should it be required to do so. If it were to use its reserves for this purpose, however, this would significantly 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

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 2019-20 have been prepared on this basis.

3 Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property, transport and social value considerations.

4 Background Papers

Papers held electronically by Technical Section, Finance & ICT Division, Room 137.

5 Officer's Recommendation

That Audit Committee 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 2019-20.

PETER HANDFORD

Director of Finance & ICT