**Audit Committee**

**28 June 2012**

# Consideration of 'Going Concern Status' for the Statement of Accounts for the year ended 31 March 2012

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### Purpose of the Report

1. The Audit Commission has asked that Durham County Council assess whether it should be considered a 'going concern', and whether the accounts should be prepared on that basis. This report considers the County Council's status as a going concern.

### Background

2. The general principles adopted in compiling the Statement of Accounts are in accordance with the 'Code of Practice on Local Authority Accounting 2011/12' (the Code) as published by the Chartered Institute of Public Finance and Accountancy (CIPFA). The Code defines proper accounting practices for local authorities in England, Wales, Scotland and Northern Ireland.

3. The Code requires that a local authority's Statement of Accounts is prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the authority will continue in operational existence for the foreseeable future. This means that the Comprehensive Income and Expenditure Statement and Balance Sheet assume no intention to curtail significantly the scale of the operation.

4. An inability to apply the going concern concept can have a fundamental impact on the financial statements

### Key Issues

5. The assumption that a local authority's services will continue to operate for the foreseeable future 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 therefore 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.

6. Local Authorities derive their powers from statute and their financing and accounting framework is closely monitored by primary and secondary legislation. It is a fundamental concept of local authority accounting that wherever accounting principles and legislative requirements are in conflict the legislative requirements apply.

7. An organisation must consider its financial performance to assess its ability to continue as a going concern. This assessment should cover historical, current and future performance.

**Historical Position**

8. Durham County Council became a Unitary Authority on 1 April 2009, bringing together the seven former District Councils in County Durham with the County Council.

9. The assets and liabilities of the former District Councils were transferred to the County Council on 1 April 2009. At that date, the Net Assets of the County Council was £1,240.742m, reducing to £900.094m at 31 March 2010. At 31 March 2011 there was a further decrease to £856.994m.

10. Net assets as at 31 March 2012 are £571.791m.

**Current Position**

11. The County Council holds general reserves of £21.874m at 31 March 2012 and reserves earmarked for specific future purposes of £100.425m.

12. The Net Assets of the County Council at 31 March 2012 amount to £571.791m, a decrease of £285.203m.

**Future Plans**

13. The County Council approved its budget for 2012/13 and Medium Term Financial Plan to 2015/16 in February 2012.

**Medium Term Financial Plan – 2012/13 to 2015/16**

14. The following assumptions have been utilised in developing the MTFP model for 2012/13 – 2015/16:

    (i) Government Grant reductions for the MTFP period have been developed utilising information from both the 2012/13 Finance Settlement, the CSR and the Autumn Statement. The forecast reductions in Government Grant are shown in the following table:

Forecast Government Grant Reductions

| Year | Grant Reduction £m |
|---|---|
| 2012/13 | 17.177 |
| 2013/14 | 4.930 |
| 2014/15 | 14.840 |
| 2015/16 | 11.560 |

(ii) Forecast Pay and Price Inflation levels have taken into account the 1% pay increase cap for 2013/14 and 2014/15 as detailed below:

Pay and Price Inflation Assumption

| Year | Pay Inflation | Price Inflation |
|---|---|---|
| 2012/13 | 0.0% | 2.0% |
| 2013/14 | 1.0% | 2.0% |
| 2014/15 | 1.0% | 1.5% |
| 2015/16 | 1.5% | 1.5% |

(iii) Continuing budget pressures in relation to Landfill Tax, Carbon Tax, Employer Pension Contributions, Concessionary Fares, energy price inflation and Adults Social Care demographic pressures.

(iv) All staffing budgets currently have a 3% turnover allowance deducted. In the coming years, staff turnover is expected to reduce with a 2.5% turnover rate felt to be more prudent which the report is recommending be built into the MTFP from 2013/14.

(v) Continuing need to support both the current and additional capital programmes, whilst accounting for variations in estimated investment income.

(vi) Council Tax increases for 2013/14 to 2015/16 are assumed to be 2.5% per annum.

(vii) There is a need for additional savings to be identified in 2013/14, 2014/15 and 2015/16 totalling £23.3m to achieve a balanced budget across the whole MTFP.

15. The Local Government Finance Bill, if enacted will introduce two key policies which will have a significant impact upon the MTFP from 2013/14 as detailed below:

(ii) **Localisation of Business Rates** – the Government's Local Government Resource Review (LGRR) recommends that councils should be able to retain all business rate income generated locally. This would provide a constant income stream and could incentivise councils to grow their local economies on the basis that they will be able to retain the additional business rates generated from any new businesses and growth in existing businesses. The business rate income would replace Formula Grant received from Government. To ensure no Council is favoured or penalised, a system of 'top ups' and 'tariffs' will be introduced as a starting point. Beyond this time however, a significant proportion of the Council's ongoing income, will in effect depend upon the health and vitality of the local economy. This will be a significant risk for the Council as there is little, if any link, between the local economy and the demand for major services such as for example; care provision for the elderly and safeguarding services for children. The MTFP model makes no assumptions at this stage of the likely financial impact of this policy.

(iii) **Localisation of Council Tax Benefit Support** – the Government intends to implement this policy also from 1 April 2013. Before implementation, the Government intends to top slice 10% of council tax benefit funding, which equates to circa £5.6m for County Durham. The Council will become responsible for developing a policy to distribute council tax benefit although the Government will stipulate that key vulnerable groups, such as pensioners, must be protected. This is likely to result in people of working age facing a disproportionate impact. The MTFP model assumes the funding reduction from withheld council tax benefit funding will be fully passported via a revised Council Tax Benefit Scheme. The Council will also be financially responsible for any increased costs due to residents claiming additional benefit, especially during a period of recession.

16. A balanced MTFP model has been developed after taking into account the assumptions detailed above. The MTFP model is summarised in the following table:

**MTFP Summary Position**

| | 2012/13 | 2013/14 | 2014/15 | 2015/16 | TOTAL |
|---|---|---|---|---|---|
| | **£m** | **£m** | **£m** | **£m** | **£m** |
| Reduction in Resource Base | 5.440 | 5.030 | 12.873 | 7.315 | **30.658** |
| Budget Pressures | 21.180 | 15.876 | 11.584 | 13.467 | **62.107** |
| **Savings Required** | **26.620** | **20.906** | **24.457** | **20.782** | **92.765** |

**2012/13 Proposals**

17. The Council continues to face unprecedented levels of reductions in Government grants over the current Comprehensive Spending Review (CSR) period to 31 March 2015.

18. In total, the County Council is forecasting that Government Support for the five year period 2011/12 to 2015/16 will reduce by £108.7m and by £115.8m when including the forecast grant reduction for 2016/17. This equates to a 30% reduction in Government Support over this period.

19. After also taking into account estimated base budget pressures and growth in some priority service areas, the County Council is forecasting the need to deliver £159.2m of cash savings for the five year period 2011/12 to 2015/16 and savings of £171.8m when including forecasts for 2016/17. This equates to a 40% net revenue budget reduction over this period.

20. Despite having to make the above unprecedented level of savings, the County Council agreed a net revenue budget of £432.58m for 2012/13. Although the budget requires the delivery of £26.6m in 2012/13 in order to deliver a balanced budget, it is also able to protect and increase some service budgets for the benefit of council tax payers.

21. The 2012/13 budget also absorbs several significant cost pressures including:

- Landfill tax of £1.07m due to the Government increasing the costs of landfill by £8 per tonne from April 2012;
- Additional employer pension contributions of £1.2m due to a 5.3% increase on the sum required to recover the forecast deficit for County Council employees on the Pension Fund;
- Concessionary fares - due to the increasing numbers of pensioners qualifying for bus passes, the increasing patronage on bus services

and the withdrawal of Government Grants to bus companies, the concessionary fares budget is forecasted to increase by £0.85m;

- Excessive inflation experienced during 2011/12 on energy and fuel costs has required £1.35m and £1.0m to be added to base budgets in 2012/13.

22. After taking into account base budget pressures and savings, the Council's 2012/13 Net Budget Requirement is £432.58m. How the Budget is financed is detailed below:

Financing of 2012/13 Budget

| Financing Method | Amount |
|---|---|
| | **£m** |
| NNDR | 219.007 |
| Revenue Support Grant | 4.245 |
| Council Tax | 201.788 |
| Council Tax Freeze Grant | 4.989 |
| New Homes Bonus | 2.551 |
| **TOTAL** | **432.580** |

**Capital Funding**

23. The Council continues to strive to attract grant funding from external sources and was recently successful in receiving a grant of £6.9m for improving Superfast Broadband access in remote areas across the County.

24. Funding of £3.8m has also been confirmed from the Housing and Communities Agency to improve four Gypsy and Travellers' sites across the County. These much needed improvements will start in 2012/13.

25. Government support for Capital investment in schools has significantly reduced below expectation for 2012/13 with a £3.6m reduction from the 2011/12 levels.

26. After taking into account external grants, forecasted income from capital receipts and unsupported prudential borrowing, there will be enough funding for the Council to be able to make new investments of £60.2m in 2012/13 and £43.3m in 2013/14 in addition to the current earmarked schemes in the Capital Programme. This would result in the Council having a Capital Programme of £359.4m across the 2012/13 to 2015/16 three year MTFP period as shown in the following table.

| Service Grouping | 2012/13 | 2013/14 | 2014/15 | 2015/16 | Total |
|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m |
| ACE | 3.703 | 2.619 | - | - | 6.322 |
| AWH | 2.059 | 1.862 | 4.584 | - | 8.505 |
| CYPS | 96.580 | 42.055 | 0.533 | - | 139.168 |
| Neighbourhoods | 29.867 | 15.949 | 1.054 | - | 46.870 |
| RED | 43.079 | 17.038 | 0.250 | - | 60.367 |
| Resources | 22.148 | 5.650 | 0.491 | - | 28.289 |
| Other | - | 9.924 | 30.000 | 30.000 | 69.924 |
| **Total** | **197.436** | **95.097** | **36.912** | **30.000** | **359.445** |
| **Financed by** | | | | | |
| Grants & Contributions | 85.490 | 44.172 | - | - | 129.662 |
| Revenue and Reserves | 5.426 | 1.607 | 0.807 | - | 7.840 |
| Capital Receipts | 18.634 | 10.000 | 10.000 | 10.000 | 48.634 |
| Capital Receipts – BSF/Schools | 2.974 | 8.000 | 3.000 | - | 13.974 |
| Borrowing | 84.912 | 31.318 | 23.105 | 20.000 | 159.335 |
| **Total** | **197.436** | **95.097** | **36.912** | **30.000** | **359.445** |

27. The County Council has been able to set a balanced budget for 2012/13 and has a plan in place to continue to deliver local services up to 2016. Based on this, it is clear that the County Council is a going concern.

**Financial Reserves**

28. The County Council holds reserves as

- A working balance to help cushion the impact of uneven cashflow and avoid unnecessary temporary borrowing – this forms part of the general reserve
- A contingency to cushion the impact of unexpected events or emergencies – this also forms part of General Reserves.
- A means of building up funds, earmarked reserves, to meet known or predicted liabilities.

29. Bearing in mind the current levels of general reserves and the risks facing the Council, the Council has adopted the following policy for reserves, in summary,

- To set aside sufficient sums in earmarked reserves as it considers prudent to do so.
- Aim to maintain, broadly, general reserves of between 3% and 4% of the budget requirement which equates to £13m to £17m.

30. Earmarked Reserves will be established to provide resources for specific purposes. Protocols will be established for each new reserve and the Corporate Director Resources will review the appropriateness of reserves on an annual basis.

31. Each Earmarked Reserve, with the exception of the schools reserve, is reviewed on an annual basis. The Schools' reserve is the responsibility of individual schools with balances at the year end which make up the total reserve.

32. The actual General Reserve balance of £21.874m as at 31 March 2012 is higher that the County Council's current General Reserve policy of maintaining the reserve between 3% - 4% (£13m - £17m) of net Revenue Expenditure. The policy will be reviewed as part of the 2013/14 budget setting process due to the potential significant risks associated with the upcoming introduction of new arrangements for Business Rates and Council Tax Benefit from 1 April 2013.

33. Based on the level of reserves held, the County Council has demonstrated robust financial management that underpins its status as a going concern.

**Risk**

34. A number of risks will need to be managed and mitigated during the MTFP process. These risks will be assessed continually throughout the MTFP four year period. Some of the key risks already identified include:

    (i) Ensure the achievement of a balanced budget and financial position across the MTFP period.

    (ii) Ensure all savings are risk assessed across a range of factors e.g. impact upon customers, stakeholders, partners and staff.

    (iii) The Finance Settlements for 2013/14 and 2014/15 are estimated based upon the original CSR 2010. The Government has confirmed that the next Finance Settlement will be for the two year period 2013/14 to 2014/15 but will not be announced until December 2012. This leaves Councils little time to plan effectively, especially if the settlement should be significantly worse than forecast.

    (iv) The localisation of the Business Rates from April 2013 will result in the Council being subject to a wide range of risks relating to the state of the local economy over which the Council will have very little control. The MTFP Model assumes the outcome for the County Council will be cost neutral after receiving a 'top-up' payment.

(v) Pay Award – the current 2012/13 budget model assumes there will be no pay award.

(vi) Localisation of Council Tax Support from April 2013 – the Government is to top slice the Council Tax Benefit Transfer by 10% which equates to circa £5.6m. The Model assumes this impact will be passported fully via a revised Council Tax Benefit Scheme.

(vii) The MTFP model builds in assumptions in relation to Concessionary Fares. There are still inherent risks however in relation to bus services due to inflationary pressures linked to fuel, further pressures due to withdrawn Government grants, and increases in demand.

(viii) AWH relies heavily on the independent sector to provide adequate volumes of appropriate services for service users. Market pressures and increases in minimum wage levels will mean that the rates the Council pays will require careful consideration in the later years of the MTFP period.

35. Based on the above there are no risks which would indicate that the County Council is not a going concern.

**Conclusion**

36. When approving the accounts, the Audit Committee members being those charged with governance for the County Council will need to consider which of the following three basic scenarios is the most appropriate:

- the body is clearly a going concern and it is appropriate for the accounts to be prepared on the going concern basis;
- the body is a going concern but there are uncertainties regarding future issues which should be disclosed in the accounts to ensure the true and fair view;
- the body is not a going concern and the accounts will need to be prepared on an appropriate alternative basis.

37. Based on the assessment undertaken, in my view:

- the County Council has a history of stable finance and ready access to financial resources in the future,
- there are no significant financial, operating or other risks that would jeopardise the County Council's continuing operation.

38. Therefore the County Council is clearly a going concern and it is appropriate for the Statement of Accounts to be prepared on that basis.

## Recommendaton

39. It is recommended that the County Council should be considered as a going concern and that the Statement of Accounts should be prepared on that basis.



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## Appendix 1:  Implications

**Finance -**

The report considers the County Council as a ‘going concern’.

**Staffing -**

None

**Risk -**

None

**Equality and Diversity / Public Sector Equality Duty -**

None

**Accommodation -**

None

**Crime and Disorder -**

None

**Human Rights -**

None

**Consultation -**

None

**Procurement -**

None

**Disability Issues -**

None

**Legal Implications -**

None