Appendix J

Budget risks and adequacy of reserves

When setting the draft budget and MTFP, Corporate Directors have provided their best estimate of their service costs and income based on the information currently available to them. Within these estimates we have set challenging targets to bear down on future demand and price increases in order to set an affordable and balanced budget. This approach of setting challenging targets for holding down prices and demands is part of a planned strategy to revise the way in which the budget and medium-term plan are developed so that alternative actions including policy choices are considered as part of the response to growth demands using an outcomes based approach. It is acknowledged that this does not come without risks particularly as we transition to the new budgeting approach. In addition there will always be factors outside of the Council's direct control which have the potential to vary the key planning assumptions that underpin those estimates.

There are a number of significant risks that could affect either the level of service demand (and therefore service delivery costs) or its main sources of funding. In addition, there are general economic factors, such as the level of inflation and interest rates that can impact on the net cost of services going forward. Pressures in service demand are demonstrated in children's and adults social care, waste volumes, take-up of concessionary bus travel, and home to school and special educational needs transport.

Similarly, there are opportunities to either reduce costs or increase income which will not, as yet, be fully factored into the planning assumptions. The main risks and opportunities are summarised below.

Risks

Covid-19 Pandemic

- Ongoing measures for public health and wellbeing – both residents and staff
- Latent service demand and increased complexity of needs – especially mental health, social care, drug and alcohol misuse and domestic abuse
- Government's response to the level of national debt

Impact of decision to leave European Union (Brexit)

- Increased border controls impacting on council responsibilities and the wider local community
- Supply chains could be affected by any changes in procurement legislation, and there are potential cost implications associated with currency fluctuations.
- The implications for pension funds are mixed as global investment vehicles have already priced in much of the uncertainty, but valuations on balance sheets and the cost of borrowing may lead to greater vulnerability.

- Commercial strategies may need to take into account the potential for any downturn in demand for properties in their investment portfolios which impact rental income and profitability.

Regulatory Risk

- **Statutory overrides** – currently there are a number of statutory overrides in place which reduce short term risks e.g. high needs deficit, investment losses, etc. These are time limited and pose significant risk if not extended
- **One-off funding settlement for 2022-23** - adequacy of the overall settlement and reliance on council tax over the medium term
- **Reforms to Social Care Charging** - uncertainty over future funding and insufficient information on full cost of the reforms
- **Departmental Specific Grants** - Unanticipated changes in specific departmental grants and ability to adjust spending in line with changes
- **New Burdens** – Adequacy of funding commensurate with additional responsibilities
- **Local Government Funding Review** - The government has committed to updating and reforming the way local authority funding is distributed to individual authorities. The Fair Funding Review of the distribution methodology for the core grants was first announced as part of the final local government settlement for 2016-17. The data used to assess funding distributions has not been updated for a number of years, dating from 2013-14 to a large degree, and even as far back as 2000. The renewed commitment in the 2022-23 local government settlement announcement to update the distribution methodology together with the introduction of a new one-off Services Grant in 2022-23 which will not be included in the baseline for future allocations adds further uncertainty whether funding from the non-council tax elements of the Council's budget will be more, flat, or less than 2022-23.

General Economic Factors

- Inflation continues to be well above the government target for a sustained period with consequential impacts on contracted services (see below) and household incomes (including incomes of KCC staff)
- Economic growth slows down or disappears
- A general reduction in debt recovery levels
- Reductions in grant and third party funding
- Reductions in the level of income generated through sales, fees and charges
- Increase in fraud

Increases in Service Demand

- Adult Social Care homecare and residential care services
- Children's Social Care including an increase in the number of looked after children, unaccompanied asylum seekers or those with no recourse to public funds
- Education and Health Care Plans with consequential impact on both Dedicated Schools Grant High Needs placements/services and General Fund services for assessment and home to school transport
- Waste tonnage
- Public health services
- General demographic trends (including a rising and ageing population)
- Impact of unemployment and changes to Welfare Benefits

Contractual Price Increases

- Index linked contracts rise above budgeted amounts
- Containing locally negotiated contracts within the amounts provided in the budget
- Financial sustainability of contracted providers

Efficiencies and Savings Programme

- Slippage in the expected delivery of the savings programme
- Non-delivery of savings remains a risk to the Council and will be monitored during the year
- Shortfalls in income from fees and charges

Opportunities

- Growth in local taxbase for both housing and businesses
- Service transformation and redesign including digital services
- Invest to save approach to reduce revenue costs
- Service remodelling

Adequacy of Reserves

Reviewing the level of reserves the Council holds is an important part of the budget setting process. The review must be balanced and reasonable, factoring in the current financial standing of the Council, the funding outlook into the medium term and beyond, and most importantly, the financial risk environment the Council is operating in. The assessment of reserves is based on factors recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) as set out below together with an indication of the direction of travel (up arrow represents an improved position i.e. the risk is less than it was last year).

Assumptions for inflation	↓	The annual rate of inflation (using CPIH) has been on an upward trend since being consistently under 1% between April 2020 and March 2021. Since March the rate of inflation has been rising to 2.4% in June (with an unexpected fall to 2.1% in July) but rising thereafter each month to 2.9% in September, 3.8% in October, 4.6% in November and 4.8% in December. Increases in CPI and RPI have been even greater. The latest Bank of England forecasts are for the rate of inflation to continue to rise during Spring 2022 before the rate of increase starts to decline but is not anticipated to reduce to the 2% target until late in 2023 or in 2024.
Estimates of the level and timing of capital receipts	↓	The Council uses receipts as part of the funding for the capital programme. The Council has not applied the flexible use of capital receipts to fund revenue costs since the 2018-19 budget and does not propose to use the extension to 2022-23. Delivery of receipts against the target has fallen behind in recent years necessitating additional short-term borrowing/use of reserves. Performance in the current year has been sluggish due to the economic turbulence and although there is a reasonable pipeline of assets for disposal the risk profile for potential delays remains high.
Capacity to manage in-year budget pressures and strategy for dealing with demand and service delivery in the longer term	↓	2021-22 has been a highly volatile year due to the ongoing Covid-19 pandemic and unpredictable recovery. A number of council services have faced significant increases in demand and costs coupled with under delivery of savings plans. The forecast overspend has increased during the year counter to previous trends which have seen early forecast overspends decline during the year. The pandemic has continued to place substantial additional spending pressures and income losses on the Council although to date additional grants from central government have been largely sufficient to cover these in the short-term. The longer-term consequences remain uncertain.

		Although the local government finance settlement for 2022-23 is within the range forecast following the October Spending Review it is still insufficient to fully fund additional spending growth and still relies on council tax increases.
Strength of financial reporting and ability to activate contingency plans if planned savings cannot be achieved	↓	There continues to be a reasonable degree of confidence in the validity of financial reporting despite the uncertainties and volatility caused by the pandemic and recovery. Reporting continues to include separate analysis of budget variances for business as usual activities and the impact of Covid-19 although the ability to separate these causes is becoming increasingly more difficult. Reporting has also been enhanced to include separate analysis of delivery of savings plans, treasury management and council tax collection. Improvements are planned in terms of the timeliness of financial monitoring and reporting to ensure corrective action is taken as early as possible. Some areas of spending can still be changed at short notice if required as a contingency response if planned savings cannot be achieved (or there are unexpected changes in spending). However, the scale and timing of overspends and under delivery of savings in 2021-22 is such that it is still uncertain what the final outturn for the year will be and whether further draw down from reserves will be needed at year end over and above the £18m already incorporated in the 2021-22 budget. .
Risks inherent in any new partnerships, major outsourcing arrangements and major capital developments	↓	Partnership working with NHS and districts has improved. However, further sustained improvements are still needed to change the direction of travel. Trading conditions for Council owned companies have been incredibly challenging.. A number of outsourced contracts are due for retender and although provision for revised tender costs have been made in the budget the Council is still vulnerable to price changes due to market conditions. The ability to sustain the capital programme remains a significant challenge. Slippage within the programme has also remained at unacceptable levels. The capital planning horizon has been extended to 10 years, up to 2022-32 for rolling programmes. This together with a new reserve to fund feasibility costs will help to reduce the slippage by creating a more realistic programme. The introduction of a new capital monitoring and reporting solution in the new financial year, will provide more detail and transparency on the capital

		programme. The capital programme focuses on securing the Council’s statutory responsibilities although there are still shortfalls in funding for some elements of the programme. The Council has recognised that increasing borrowing to unsustainable levels to fund infrastructure is not an option.
Financial standing of the Authority (level of borrowing, debt outstanding, use of reserves, etc.)	⟺	The Council included additional contributions to general reserves in the 2021-22 budget, increasing them to the target of 5% of the net revenue budget in response to increased risks and to improve resilience. The 2022-23 budget proposes to maintain general reserves at this 5% level, requiring a further contribution of £2.5m. The Council has also undertaken a comprehensive review of its existing reserves and established new reserves to meet the cost of ICT investments required to deliver the council’s Strategic Reset Programme objectives and to cover feasibility work undertaken to support capital programme planning and delivery. KCC (like many councils) had significant underspends in 2020-21. These arose from a combination of the impact of lockdowns on council services as well as timing differences between the receipt of Covid-19 grants and spending. Reserves at the end of the year were consequently higher even after allowing for the rollover of committed spending. The Council agreed a Covid-19 earmarked reserve be established to deal with the smoothing of grant funding and spending between financial years. It is likely this reserve will need to persist into 2022-23. However, this does not in itself strengthen the financial standing of the authority as the reserve is likely to be needed to cover further impacts arising from the pandemic. The 2022-23 budget includes the transfer of insecure funding (time-limited grants and dividends) to a Strategic Priorities reserve and the County Council’s share of the proceeds from the business rate pool to Economic Development reserve rather than to support core spending. The 2022-25 medium term financial plan shows an overall balanced position although the individual years for 2022-23 and 2023-24 rely on the use of one-off funding from a smoothing reserve. The 2022-23 budget also relies on one-off surplus from Council Tax Collection Fund from 2021-22 (as well as accounting for 2020-21 deficit over three years).

		The levels of legacy borrowing remain relatively high with 85% of debt not due to mature within the next 10 years. The debt includes loans taken out under the previous supported borrowing regime and more recent loans taken out under the prudential regime. Over 10% of debt is in long term Lender Option Borrower Option Loans which can only be redeemed without significant penalties at the lender’s discretion. In recent years the Council has adopted a policy of funding additional borrowing requirements from reserves rather than additional external borrowing. Whilst this remains sustainable for the next 2 to 3 years without impacting on long term investments it needs to be kept under review. All of these measures are necessary to improve the financial sustainability of the Council in response to current challenges. However, in spite of these measures the overall financial standing of the Council remains constant rather than improving.
The Authority’s record of budget and financial management including robustness of medium-term plans	⟷	The Council has a sound record of effective financial management delivering the outturn within budget and with a small underspend in each of the 20 years up to 2019-20. The unique circumstances of the Covid-19 pandemic and subsequent recovery resulted in a more significant underspend in 2020-21 and a persistent level of forecast overspend for 2021-22. Since many of the reasons are due to external and uncontrollable factors this has not led to a worsening of the rating for financial management at this juncture but there will need to be robust financial management in 2022-23. Due to uncertainty over future government settlements the Council did not formally publish a medium-term financial plan for 2020-23 or 2021-24. The 2021-22 budget included a medium-term outlook based on a number of potential scenarios. A balanced medium-term plan for 2022-25 has been presented as part of the 2022-23 budget based on prudent assumptions for future spending, council tax and government funding although the balanced position can only be achieved with £100m of savings/income over the three years. Plans for some of these savings are still under development especially for later years.

Virement and year-end procedures in relation to under and overspends	⟺	The Council continues to adhere to sound financial governance and virement procedures set out in its financial regulations. The Council's ability to close the year-end accounts early is becoming increasingly difficult. For reasons outside the Council's control audit certificates for 2019-20 and 2020-21 have still not been issued. The draft outturn for 2020-21 was reported to Cabinet on 24th June outlining the main overspends and underspends together with roll-forward requests. This was presented alongside an update to the medium-term financial outlook. A net underspend of £27.5m was reported after roll forwards of £42.5m. The draft accounts were approved in November 2021 and signed off in December 2021.
The availability of reserves and government grants/other funds to deal with major unforeseen events	⬇	The Council continues to have adequate reserves although a number of significant risks remain unresolved which could impact on reserves if a solution is not found. The most significant risk is the continuing and growing deficit and accumulated debt on the High Needs Block of Dedicated Schools Grant (DSG). This relates to spending to support children and young people with Special Educational Needs and Disabilities (SEND). Since the introduction of the Children and Families Act 2014, the Council has seen an unprecedented rise in the number of children and young people assessed for Education and Health Care Plans (EHCPs). The high needs funding within the DSG has not kept pace resulting in in-year overspends and an accumulated deficit on the unallocated DSG reserve. This is a national problem but has been particularly acute in Kent and a number of other councils. To date the government has not provided councils with sufficient funding and has not introduced structural reforms to eliminate the overspends or repay the deficits. Whilst the government has confirmed that DSG deficits do not have to be covered from the General Fund up to at least March 2023, the level of debt remains unsustainable posing a considerable risk in the absence of funding and structural reforms. The Council has updated its DSG deficit recovery plan with the aim of initially reducing the rate of growth and ultimately starting to repay the accumulated debt. However, this will take several years. It is critical that the deficit recovery plan is delivered to reduce the level of deficit as soon as possible.

		The Council has set services challenging targets to bear down on future price increases and service demands. This is not without considerable additional risk even though this is part of a planned strategy to revise the way in which the budget and medium-term plan are developed so that alternative actions including policy choices are considered as part of the response to growth demands using an outcomes based approach. A comprehensive risk register is published as part of the 2022-23 revenue budget, 2022-25 medium term plan and 2022-32 capital programme. .
The general financial climate including future expected levels of funding	⟺	Spending Review 2021 included departmental spending plans for three years 2022-23 to 2024-25. However, the provisional local government finance settlement only included grant allocations, council tax referendum levels and core spending power calculations for 2022-23 with no indicative amounts for 2023-24 and 2024-25. Departmental specific grants were not included in the settlement and are announced later. Furthermore, the announcement of the government's intention to update and reform the funding arrangements for local government adds further uncertainty over future funding. Added to the lack of indicative funding settlement is a worsening of the ability to forecast additional spending demands and council tax/business rates funding following the pandemic and recovery. The combination of these makes medium term financial planning highly uncertain. Plans can only be prepared based on prudent assumptions and forecasts for later years remain highly speculative.
The adequacy of insurance arrangements	⟺	The Council's insurance policies were reviewed for January 2022. A hardening market along with changing levels of risk has resulted in a rise in premiums, with some deductibles being increased to mitigate this. A fund audit confirms the levels of insurance reserve are adequate.

Of the eleven factors used to assess risk and the adequacy of reserves, none have shown an improvement from twelve months ago, five are relatively unchanged, and six have deteriorated. No weighting has been applied to the individual factors, but the general financial risk to the Council should now be regarded as increased compared with a year ago, which in turn, was increased from the year before.

The amounts and purposes for existing reserves have been reviewed to ensure the Council enhances compliance with Local Authority Accounting Panel (LAAP) Bulletin 99. This bulletin set out the recommendations on the purposes for holding reserves. Reserves are split between general reserves (working balance to help cushion the impact of uneven cashflows/avoiding unnecessary temporary borrowing and contingency to cushion the impact of unexpected events/emergencies) and earmarked reserves to build up funds for known/predicted specific events. The review included the closure of reserves where the original predicted events are now unlikely and the establishments of new reserves.

The 2022-23 draft budget also includes a £4.5m net impact from changes in the use of reserves. This includes additional contributions to reserves of £14.1m, (including £8.4m to strategic priorities and £3.0m to economic development/regeneration reserves from variable funding sources, and a one-off additional contribution of £2.5m to general reserves to maintain these at 5% of the proposed 2022-23 net revenue budget). The strategic priorities reserve will be used to fund non-recurring/time limited projects and initiatives to support delivery of the Council's key priorities as set out in the Strategic Statement which will be considered by County Council in May. These additional contributions are offset by £8.7m additional drawdown from public health and smoothing reserves. The budget also reflects a net £0.9m removal of one-off contributions and drawdowns in 2021-22. The use of the smoothing reserve in 2022-23 is to take account of timing differences between spending requirements, funding and income sources, and delivery of savings.