Budget risks and adequacy of reserves

The assessment of budget risks and the adequacy of reserves is particularly important for 2023-24 and the medium-term plan due to the extraordinary economic consequences of global and national circumstances and the impact on national public spending and local capital and revenue spending. This has significantly heighted the risks the Council faces, and it is more essential than ever that the Council is sufficiently financially resilient to avoid the risk of financial failure leading to the Council losing the ability to manage its finances. At a local level the scale of the in year overspend and its likely impact on the draft budget and Medium Term Financial Plan (MTFP) and reserves, also add to the importance of the assessment.

The administration's draft budget and MTFP is informed by the best estimate of service costs and income based on the information currently available. It is acknowledged that this does not come without risks particularly as we transition to the new Outcomes Based 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 evident in children's and adults social care, waste volumes, and home to school and special educational needs transport.

There are also 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

Cost of Living

- Extraordinary increases in the costs of goods and services procured by the Council
- Market instability due to workforce capacity as a result of recruitment and retention difficulties leading to exit of suppliers, increased costs, and supply chain shortages
- Increased demand for Council Services over and above demographic demands, including crisis and welfare support
- Reductions in income from fees and charges
- Under collection of local taxation leading to collection losses and reductions in tax base
- Increase in Local Council Tax Reduction Scheme discounts

Global Factors

- Impact of the Russian invasion of Ukraine
- Impact of the decision to leave the European Union
- Legacy impact of covid-19
- Ongoing supply chain disruption including energy supplies
- Breakdown of hosting arrangements under Homes for Ukraine scheme

Regulatory Risk

- **Replacement Legislation and Regulation following Brexit** – including additional council responsibilities, impact on businesses and supply chains, and economic instability
- **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 require a long-term solution
- **Funding settlements** - adequacy of the overall settlement and reliance on council tax over the medium term, and uncertainty over future settlements (especially beyond 2024-25)
- **Delayed Reforms to Social Care Charging** - uncertainty over future plans and funding, and providers' fee expectations
- **Departmental Specific Grants** - Unanticipated changes in specific departmental grants and ability to adjust spending in line with changes
- **Asylum and Refugee Related** – increase in numbers of refugees (adults and families) accommodated within the community impacting on council services. Inadequate medium-term government funding for refugee schemes
- **New Burdens** – Adequacy of funding commensurate with new or additional responsibilities
- **Further delay of the Local Government Funding Review** - The government has committed to updating and reforming the way local authority funding is distributed to individual authorities. However, this has now been further delayed until 2025-26 at the earliest. 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.

General Economic & Fiscal Factors

- Levels of national debt and borrowing
- 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 recession
- Rise in unemployment
- A general reduction in debt recovery levels
- Reductions in grant and third-party funding
- Increase in fraud

Increases in Service Demand

- Long term impact of Covid-19 pandemic on clients and suppliers
- Adult Social Care demography from increased complexity
- Children's Social Care including an increase in the number of children in care, unaccompanied asylum seekers or those with no recourse to public funds
- Significantly higher than the national average 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 and growth in the number of vulnerable persons)

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 planned savings
- 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 July 2021 rising from 2.1% to 4.9% by January 2022, 8.8% July in 2022, and 9.6% in October 2022 before a slight fall to 9.2% in December. Increases in CPI (10.5% in December 2022) and RPI (13.4% in December 2022) have been even greater. The latest Office for Budget Responsibility forecasts are for the rate of inflation to peak in quarter 4 of 2022, before the rate of prices growth falls back a little in the first quarters of 2023 with more significant reductions in later quarters and into 2024, with negative inflation forecast later 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 permitted extension. Delivery of receipts against the target has continued to fall 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 falls in property demand and house prices. 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	↓	2022-23 has been an extraordinary year due to the economic consequences of global and national circumstances. A number of council services have faced significant increases in demand and costs due to inflation, market instability and shortages, changing client needs, coupled with under delivery of savings plans. The forecast overspend for 2022-23 is unprecedented and has not significantly reduced during the year counter to previous trends which have seen early forecast overspends decline during the year. The early indications are that the forecast for quarter 3 will show an overall reduction compared to quarter 2 from a combination of management action to reduce spending and some further emerging growth. However, the quarter 3 forecast is still likely to show a significant overspend placing pressure on the Council's reserves.

		The economic context has continued to place substantial additional spending pressures and income losses on the Council which have not been adequately reflected in the increased settlement from Government. The settlement still relies on increases in council tax.
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 economic circumstances. However, the ability to activate contingency plans if planned savings cannot be achieved has to date been severely restricted although every effort is being made to reduce the forecast overspend in 2022-23. Reporting has been enhanced to include separate analysis of delivery of savings plans, treasury management and council tax collection. Further 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 2022-23 is such that it is still uncertain what the final outturn for the year will be and what level of further draw down from reserves will be needed at year end over and above the £25m already set aside in a risk reserve established to mitigate the impact of uncertainty and volatility. The growth and savings in the administration's proposed final draft budget 2023-24 are being independently reviewed to give assurance on deliverability, and to verify the delivery plans for each one including the key milestones such as consultation, key decisions, and implementation. Given the scale of the savings, enhanced monitoring arrangements will be put in place in addition to the arrangements already embedded through the monthly monitoring with budget managers and regular quarterly budget monitoring reports to Cabinet. These enhanced arrangements will include review meetings with Cabinet Members and regular monthly updates from Corporate Directors on progress to deliver savings plans identifying where key milestones have been met (and where any have not been met), and feedback from any consultation leading to variations from the original plan. Where milestones have not been met or plans changed following consultation the updates will identify remedial actions

		necessary to ensure the overall budget can be delivered as well as further management action. The independent review and enhanced monitoring and reporting arrangements will be key in ensuring the savings delivery plans are achieved, however given the level of savings required to deliver a balanced budget, the ability to activate contingency plans to identify alternatives is likely to be very limited
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 continue to be incredibly challenging. A number of outsourced contracts are due for retender and the Council is still vulnerable to price changes due to market conditions. The ability to sustain the capital programme remains a significant challenge. It is essential that capital programmes do not rely on unsustainable levels of borrowing and additional borrowing should only be considered where absolutely essential to meet statutory obligations. This will impact on the condition of non-essential assets possibly resulting in the closure of facilities. However, despite the action taken to limit additional borrowing, a third of the capital programme is still funded by borrowing. Slippage within the programme has remained at unacceptable levels. The capital planning horizon has been extended to 10 years, up to 2033 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 development of a new capital monitoring and reporting solution in the new financial year, will provide more detail and transparency on the capital programme.
Financial standing of the Authority (level of borrowing, debt outstanding, use of reserves, etc.)	↓	The financial standing of the Council is forecast to significantly weaken in 2023-24 pending the final outturn for 2022-23, before a planned recovery in 2024-25. This weakening for 2023-24 includes a lesser net contribution to reserves than in recent years, the risk of significant draw down from reserves at the end of 2022-23, and the need to start making provision for the DSG deficit from 2023-24 onwards.

On a positive note, the 2022-23 budget maintained general reserves at 5% of net revenue budget through a contribution of £3.0m. The 2022-23 budget also included 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/Regeneration reserve rather than to support core spending. The Council was able to strengthen earmarked reserves in 2022-23 budget including further contributions to a risk reserve to mitigate increased uncertainty and volatility.

However, these additional contributions are offset by draw down from reserves. These include the planned draw down from corporate reserves in the 2022-23 budget and the administration's proposed final draft budget for 2023-24 to achieve a balanced budget. Furthermore, if the level of the current year overspend is not reduced by year end this will require further draw down from reserves. For the first time in several years the overall level of reserves is forecast to reduce by the end of the financial year.

The transfer of insecure funding to reserves is not included in the administration's proposed final draft 2023-24 budget and instead will contribute to core spending. The administration's proposed initial draft 2023-24 budget maintained a general reserve in line with the policy to maintain these at 5% of net revenue budget. The reserves position will be further weakened by the need to start making provision for a contribution to the DSG deficit from 2023-24 onwards putting further pressures on reserves

The levels of legacy borrowing for capital spending 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. The recent rise in interest rates has opened up an opportunity to refinance some loans on better terms due to the impact interest has on discount rates. 11.2% of debt is in long term Lender Option Borrower Option Loans which can only be redeemed with significant penalties at the lender's discretion.

In recent years, the Council has adopted a policy of funding additional borrowing requirements internally from reserves rather than from 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. Contributions to reserves and not increasing external debt are necessary to improve the financial sustainability of the Council in response to current challenges. However, the overall financial standing of the Council is forecast to weaken for 2023-24 before improving for 2024-25 and beyond, although this improvement is predicated on all the planned savings being delivered and on time, and that the budget is broadly balanced at the year end.
The Authority's record of budget and financial management including robustness of medium-term plans	⬇	The direction of travel for this factor has deteriorated since the initial draft in light of the early indications for quarter 3 budget monitoring in the current year. The Council has previously delivered the outturn within budget and with a small underspend in each of the 22 years up to 2021-22, although it should be noted that underlying budget pressures in the demand led services have been consistently highlighted in recent years. Financial monitoring for the first two quarters of 2022-23 has shown a significant forecast overspend well in excess of reserve provisions set aside in the budget as a result of the heightened risk that was identified at the time the budget was set. This overspend is in part due to the extraordinary economic consequences of global and national circumstances covered in the administration's final draft budget report for 2023-24. These consequences include levels of inflation not seen in last 40 years, significant market instability affecting suppliers of key council services, increased demand for some council services driving up costs, and under delivery of savings plans. As highlighted above, it is also important to note that the underlying position for both adult social care and children's services in previous years has been an overspend at year end which has been offset by underspends in other areas and drawdowns from reserves. A balanced medium-term plan for 2022-25 was presented as part of the 2022-23 budget based on prudent assumptions for future spending, council tax and government funding although the balanced position was only possible with £100m of savings/income over the three years. The volatility and uncertainty during 2022-23 has had a significant impact on the medium-term plan. This is despite an improved local government settlement for

		2023-24 and 2024-25 with additional grants albeit these are short term in nature particularly to address current pressures in adult social care and government expectations of higher council tax. The planned savings and income over the three-year period 2023-24 to 2025-26 have increased to £142m. Within this there is a weakening of council reserves for 2023-24 before a planned recovery for 2024-25.
Virement and year-end procedures in relation to under and overspends	↓	The direction of travel for this factor has deteriorated in light of the early indications for quarter 3 budget monitoring in the current year and ongoing issues with Whole Government Accounts. The Council continues to adhere to its virement and year end procedures as set out in its financial regulations. The Council's ability to close the year-end accounts early or even on time is becoming increasingly difficult. The audit certificate for 2020-21 has still not been issued, due to the audit of 2020-21 Whole Government Accounts being outstanding as the external auditors have prioritised the audit of the Council's 2021-22 accounts. The draft outturn for 2021-22 was reported to Cabinet on 23rd June 2022 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 £0.5m was reported after roll forwards of £7.1m. The draft accounts for 2021-22 were published on 1st August 2022 and are still being audited. The audit is ongoing whilst waiting for the issue of the statutory instrument by Government, setting out the approach for accounting for infrastructure assets.
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 and their adequacy if a solution is not found. The most significant risks are the forecast overspend for 2022-23, the continuing and growing deficit and accumulated debt on the High Needs Block of Dedicated Schools Grant (DSG) relating to spending to support children and young people with Special Educational Needs and Disabilities (SEND) and reduced contributions to reserves in 2023-24. The impact of the forecast overspend and reduced contributions to reserves are set out in administration's draft budget report for 2023-24.

	The High Needs deficit follows 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) which is higher than the national and nearest neighbour averages. 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. The government has started a process to consider contributing towards historic debts for those local authorities with the most significant overspends (known as the Safety Valve agreement), but only where local authorities can demonstrate they can balance their future annual budget. Whilst the government has confirmed that DSG deficits do not have to be covered from the General Fund up to at least March 2026, 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, under the Safety Valve programme 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. In the meantime, the Council will need to start making provision in reserves from 2023-24 onwards to contribute to the deficit recovery plan. A register of the most significant risks is published as part of the administration's final 2023-24 revenue budget, 2023-26 medium term plan and 2023-33 capital programme. .
The general financial climate including future expected levels of funding	The Autumn Statement 2022 included departmental spending plans up to 2024-25 and high-level spending plans up to 2027-28. The plans for 2023-24 and 2024-25 included significant additional support for local government including additional grants and increased assumptions for council tax. However, the provisional local government finance settlement only included individual grant allocations and core spending power calculations for 2023-24. The settlement did also include council tax referendum levels for 2024-25 as well as the overall additional amounts for the main grants for 2024-25. Other departmental specific grants were not included in the settlement and are announced later. The Autumn Statement and provisional local government finance settlement confirmed that the

		planned reforms to social care charging have been delayed until 2025. It is this delay that has enabled Government to redirect the funding allocated for social care reform as a short term increase in funding for current pressures in adult social care. However, the inadequacy of medium to long term sustainable funding for adults social care remains, hence the neutral direction of travel. The long-awaited update and reform to the funding arrangements for local government have also been delayed again until 2025 at the earliest. Despite increased certainty of funding for 2023-24 and 2024-25 medium term financial planning remains uncertain, particularly future spending and income forecasts due to the highly uncertain economic environment. The plans for 2025-26 include a higher level of uncertainty. 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. The implications of limiting capital borrowing to absolutely essential statutory services increases the risk of insurance claims where assets have not been adequately maintained. A fund audit confirms the levels of insurance reserve are adequate, however as the corporate contribution to the fund is remaining unchanged more reliance will be placed on the reserve to balance insurance claims.

Of the eleven factors used to assess risk and the adequacy of reserves, only one has shown no change from twelve months ago (the financial climate and expected levels of funding, and even this is only for the short-term through the improved settlement for local government in 2023-24 and 2024-25), the remaining ten have all deteriorated. Of those that have deteriorated the reduced financial standing of the council (albeit currently only shown for 2023-24 as long as planned savings are delivered and demand is managed effectively) and the ability to deliver alternative savings plans are the cause for most concern. A number of the other deteriorations are largely due to outside factors but still need to be managed and mitigated as much as possible. No weighting has been applied to the individual factors, but the general financial risk to the Council should now be regarded as significantly 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 achieves compliance with Local Authority Accounting Panel (LAAP) Bulletin 99. This bulletin sets 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 administration's proposed final draft 2023-24 budget includes a £9.9m net increase from changes in contributions and draw down from reserves. This includes additional contributions to reserves of £22.4m, including a recurring £12.0m contribution to the risk reserve, £4.5m contribution to local taxation smoothing reserve from unbudgeted council tax collection fund surplus, and an additional contribution of £5.8m to general reserves (to enable the general reserve to be maintained at 5% of the administration's proposed draft 2023-24 net revenue budget). For one year only, the transfer of insecure funding to strategic priorities reserve and economic development reserve is not repeated in the administration's proposed draft budget and the funding is being used to fund core spending in 2023-24. These are acceptable risks in the short-term but are not sustainable in the medium term.

The 2024-25 plans provide for replacement and replenishment of corporate reserves used to support 2023-24 budget and re-introduction of the transfers of insecure funding to strategic priorities to support the delivery of the Strategic Statement and economic development reserves, as well as continuing contributions to the risk reserve.

These additional contributions are offset by £12.5m additional drawdown from public health and corporate reserves; this includes a £7.9m draw down from corporate reserves to balance the administration's proposed draft 2023-24 budget. The budget also reflects a net £20.7m removal of one-off contributions and drawdowns in 2022-23.