From: Zena Cooke, Corporate Director, Finance

To: County Council

Subject: **Section 25 Assurance Statement**

Classification: **Unrestricted**

Summary:
This report sets out my view as the Section 151 officer as to the robustness of the budget estimates for the administration's proposed budget for 2023-24, the medium-term financial plan, and the adequacy of reserves. It includes an evaluation of the background to budget preparations for 2023-24, including the impact of under delivery of 2022-23, future risks and uncertainties, deliverability of the proposed budget plan, and financial sustainability of the Council. It is acknowledged that setting a balanced budget for 2023-24 has been incredibly challenging due to the extraordinary economic consequences of global and national circumstances in the current year which have added significant turbulence and uncertainty.

The 2022-23 revenue budget has an unprecedented level of forecast overspend, particularly in adults' and children's services. Whilst the latest indications are that the forecast overspend is reducing there are still some further increases. The level of the forecast overspend poses a significant risk to Council reserves if it is not brought down to the level of reserve specifically set aside for this purpose. As well as the risk to reserves, the forecast overspend adds significant spending growth pressures to the administration's draft 2023-24 budget even before any consideration of replenishing reserves that would need to be drawn down to balance 2022-23 spending.

The capital monitoring continues to show high levels of slippage. This has a short-term benefit for revenue spending as borrowing is only taken up once capital spending has been incurred. However, this does have an impact on revenue budget planning as it means amounts have been set aside for forecast future borrowing costs based on the original capital plans which increases the amounts that need to be found from savings and income to balance the revenue budget. Furthermore, the capital programme still requires significant borrowing over the lifetime of the plan with long term revenue consequences. Although the vast majority of this is not new borrowing as it is largely a continuation of the previous capital programmes, as has been highlighted in previous assurance statements the levels of historic debt represent a significant drag on the Council's financial resilience (with relatively high levels of borrowing than comparable councils). The further borrowing required to fund the programme (whether internal or external) is significant and exceeds reductions in debt through maturity. It is essential that sustainable alternatives to borrowing to fund capital spending are identified to reduce this further drag on financial resilience.

Setting a robust revenue budget for 2023-24 means the budgets with forecast overspends in 2022-23 need to reflect the full year effect of higher than budgeted

costs and demand in the current year, as well as under delivery and rephasing of savings plans and the revenue consequences of the borrowing required for the capital programme. To safeguard the Council's financial resilience, it will be essential that for 2023-24 there is a relentless focus on financial management, demand management, timely delivery of the agreed savings, with all the necessary key decisions taken in a timely manner, and that there are no additional spending requests that would add to costs over and above budgeted levels or repurposing of budget variances without following due governance processes.

Provided all the measures set out in the draft budget and medium term plan are implemented, including the delivery of the proposed revenue savings and income, resisting future spending growth, limiting the use of one-off funding including reserves with no one-off funding sources supporting the base budget by the end of 2024-25, minimising the level of borrowing for the capital programme, council tax increases and precepts, the Council will continue to demonstrate financial sustainability for the next two years, although there remains considerable uncertainty over the medium term.

Recommendations:

(a) Pursuant to section 25 of the Local Government Act, County Council is asked to CONSIDER and NOTE this report and AGREE to have due regard to the contents when making decisions about the proposed budget.

1. Background and Introduction

1.1 Section 25 of the Local Government Act 2003 requires the Section 151 officer (for Kent this is the Corporate Director, Finance) to formally give an opinion as to the robustness of the budget estimates and the level of reserves held by the Council. The Act also requires that the Council must give consideration to this report when making decisions about the budget.

1.2 It is essential that the budget includes an assessment of the potential financial risks facing the Council and that the Council has adequate reserves should those risks materialise. The Council holds a general reserve for unforeseen and unplanned circumstances and a range of earmarked reserves for specific eventualities. The proposed 2023-24 budget includes a further additional contribution to general reserves to maintain these to the previously agreed level of 5% of the 2023-24 proposed budget. However, if the current year's forecast overspend is not reduced over the remainder of the year to a level that can be accommodated from specific reserves set aside for budget risks and stabilisation, then some of the general reserve may need to be drawn down to balance the 2022-23 outturn with a consequent reduction in the Council's financial resilience.

1.3 In recent years the section 25 assurance statement has noted that the Council has maintained adequate but not generous levels of reserves and has a relatively high level of accumulated debt. The Corporate Director, Finance has undertaken an assessment of the financial resilience of the Council compared to other county councils and has concluded that KCC remains in the lower half of the resilience range. Furthermore, KCC is forecasting proportionately more significant financial growth pressures in 2022-23 and 2023-24 than other county councils and consequently if savings plans are not agreed and delivered the Council is in more imminent danger of financial failure than other comparable councils despite the strengthening of reserves in recent years. Although reserve levels are still considered to be adequate for 2023-24 (subject to the final 2022-23 outturn position), reserves will need to be further strengthened over the medium term to cover the Council's contribution to the Safety Valve agreement with the Department for Education. The level of reserves will require continuous monitoring considering the remaining level of forecast overspend in the current year (including under delivery of previous savings plans) together with the heightened risks from the wider economic circumstances. The Council cannot be complacent and must continue to maintain financial rigour, particularly with regard to accumulated debt and associated financing costs, which have in recent years benefitted from internal borrowing to a large degree.

1.4 The Council's revenue spending in previous years has been managed within the approved budget and ended the year with a small surplus. However, there has been an underlying overspend in both Adult Social Care and Children's Services offset by underspends elsewhere in the budget and drawdowns from reserves. 2022-23 has seen a significant forecast overspend which if not closed over the remainder of the year will need to be covered by reserves set aside for budget stabilisation. Whilst the Council has maintained a substantial capital programme over this period without adding to external accumulated debt, it has continued to borrow internally from cash reserves.

1.5 The Council's Constitution specifically defines the role of all Members in determining and agreeing the policy and budgetary framework of the Council in accordance with applicable laws providing sufficiency of resources. The budget approval process includes Cabinet Committee meetings, the Scrutiny Committee meeting and an informal Member briefing leading up to the formal Budget meeting and the consideration of the recommendations set out in the County Council budget report. These are the mechanisms by which all Members have the opportunity in advance of the full County Council meeting to define, challenge, amend and ultimately vote on the Council's budgetary framework for the next year and medium term, in which all Members have a voice and a vital role to play.

2. Evaluation of the administration's proposed 2023-24 Revenue Budget and Medium-Term Financial Plan

2.1 As outlined in the summary, the administration's proposed 2023-24 budget and medium-term plan have been prepared against the backdrop of considerable uncertainty and volatility.

2.2 The uncertainties of the economic environment, in particular rising inflation, a one year settlement, the scale of savings and growing demands on core services and a forecast overspend have all meant that there are significant risks facing the Authority in delivering a balanced budget. In fulfilling the various responsibilities placed on me as Chief Financial Officer, I have set out below what I see as the key risks associated with the proposed budget and how they can be managed within the Administration's proposed budget, so that Members are clear on the risks associated with these budget proposals when making their budget decision.

Risk A – Impact of Forecast Overspend

2.3 The budget monitoring position as at the end of September 2022 was reported to Cabinet on 1st December 2022. The revenue budget showed a significant forecast net overspend of £60.9m. Action to address the reported £60.9m overspend is critical to avoid an unsustainable drawdown from reserves and full year consequence of additional spending from the current year in 2023-24. It is not unreasonable to drawdown from the risk reserve, which was set aside for the increased risks arising from the post pandemic uncertainties. The quarter 2 monitoring report included £7.9m of proposed actions to reduce the overspend. The Council will need to continue to look to reduce and minimise non-essential spending for the remainder of the current year to reduce the risk of any further drawdown from general or earmarked reserves to offset overspends. The main reasons are due to a combination of rising costs (largely due to economic circumstances of extraordinary inflation and market instability including recruitment difficulties), under delivery of savings, and in some cases increased demand for services. The budget was set with contingency provisions for additional risks particularly due to the early signs of rising inflation and market sustainability issues but if the overspend is not reduced during the remainder of the year any overspend would have to be met from reserves, weakening the Council's financial resilience.

2.4 The most significant forecast overspends in children's services are on home to school transport and children in care. The most significant forecast overspend in adult social care continues to be older persons residential and nursing care. Overspends on other council services are partly due to under delivery of savings, including in some cases delays to decisions necessary to implement the original budget plan e.g. savings on supported bus services, and the impact of higher inflation (particularly streetlights/road signs and energy costs for the council's property estate).

2.5 The proposed 2023-24 draft revenue budget includes £216.8m of additional spending. This includes £63.5m for the full year effect of increased costs and demands in 2022-23, £70.4m for estimated future price increases, £34.0m for forecast future demand and cost drivers, £28.0m for government specific grant funded additional spending (offset by matching grant income), £13.9m for increased pay related costs (including removal of employer national insurance increase and lower employer pension contributions) and £2.0m for additional borrowing. This mix of revising budgets for known variances and forecast spending growth is a robust approach and provides a sound basis for financial planning, however it is critical that budgets are not simply increased to reflect increased spending, without a rigorous approach to demand and financial management.

2.6 The proposed 2023-24 budget includes estimates for future demand and price increases. Due to the considerable uncertainty about these forecasts growth based on future estimates will be held in a way that ensures it is separately identifiable so that it can be revised once the actual incidence has been evidenced. Other provisions will be held centrally and allocated during the year.

Risk B – Delivery of the Planned Savings

2.7 The proposed 2023-24 draft budget also requires the delivery of a package of £86.6m of planned savings and income. This comprises £39.1m of savings from spending reductions, £15.6m increased income from charges and contributions, and £31.9m increased income from specific government grants. Recent experience is that savings have slipped or have not been delivered at all. The magnitude of the savings required for 2023-24 significantly heightens the deliverability risk. The risk of under delivery can be mitigated provided key decisions to implement savings plans are agreed in a timely manner. The proposed budget also still includes a planned contribution to the risk reserve and maintains the general reserve at 5%. These reserves are available to counter the risk of savings delivery and any under forecast of the estimated growth pending in year confirmation, although any sizeable use of these reserves will impact on the Council's financial resilience if they are not replenished in the following year.

Risk C – High Needs Block overspend

2.8 The single greatest financial risk to the Council remains the substantial and growing deficit on High Needs spending from the Dedicated Schools Grant (DSG). This has been flagged as the biggest risk for several years with the accumulated deficit forecast to be £146.6m by the end of the current year. A statutory override has been extended by a further 3 years which means that DSG deficits do not have to be covered from the General Fund i.e. they are not cash backed. However, the Council does need to make provision to repay a proportion of the accumulated deficit from General Fund reserves as part of the Safety Valve agreement with the Department for Education. Currently there is no specific provision within General Fund reserves for this repayment. The current level of accumulated deficit remains unsustainable posing a considerable risk to the Council if there is not a significant reduction in the deficit. The assessment of financial resilience based upon the ratio of reserves to debt as a percentage of net revenue budget now includes an additional assessment for this risk. Formal regular monitoring and reporting of the local deficit recovery action plan, highlighting any corrective action, will be critical to ensure the deficit is being tackled effectively.

Risk D – Capital Programme

2.9 The capital programme continues to show a high and unsustainable level of slippage on projects. It is essential that future capital programmes are based on more realistic phasing of planned expenditure. The implementation of a 10 year capital programme, the introduction of a reserve to fund feasibility costs and the new capital monitoring and reporting solution, should ensure a more realistic capital programme with significantly less slippage, but this is still proving to be a challenge to achieve.

2.10 The capital programme as at the end of September 2022 is forecast to underspend by £74.6m, comprising +£29.1m overspending on schemes and -£103.7m rephasing into later years. Whilst the introduction of a 10-year programme from 2022-23, and a feasibility fund, together with a planned capital monitoring and reporting IT solution, should ensure capital programme budgets and delivery are more realistic in future, this is still proving to be a challenge to achieve. More work is needed to reduce the level of slippage in the programme, a review of the current arrangements is underway and will help inform any changes that may be required.

2.11 The proposed draft capital programme is £1,624m over the 10 years 2023-24 to 2033-34. The 10 year element of the plan primarily relates to the rolling annual programmes. Spending on approved projects is set out over the anticipated timescales to deliver these projects. A separate schedule of potential projects is not included as part of the approved programme to ensure that schemes in the initial stages of development and/or where funding has not been secured are not formally included in the programme too early in their development. However, minimising additional borrowing does not come without risks and consequences. This means the Council will need to prioritise maintenance and improvement works which avoid the risk of death or serious harm on the Council’s highest priority assets, with the possible closure of non-priority sites on safety grounds. This in turn will lead to an increase in maintenance backlogs and higher potential future costs. The Council also needs to investigate alternative funding mechanisms for maintenance works avoiding the need for borrowing to fund what are essentially recurring costs.

2.12 The proposed draft programme is funded from a combination of government grants, external funding and borrowing. In line with previous years, it is proposed that borrowing is supported from the Council’s cash balances rather than external debt. This not only reduces the cost of borrowing (bearing in mind the difference between returns on cash investments and borrowing rates) but also ensures the Council does not increase accumulated debt based on spending profiles which are subsequently delayed. This strategy of internal borrowing is considered sustainable for the next two to three years providing there is no significant revenue need to draw down reserves and the Council has sufficient cash balances. In the medium term this approach will need to be reviewed and revised as it will not be possible to sustain this level of capital investment without the greater achievement of savings, generation of income or increased funding. It is essential that sustainable alternatives to borrowing to fund capital expenditure are identified to avoid further drag on financial resilience.

Risk E – Impact on the Medium Term Financial Strategy

2.13 The medium-term plan shows a balanced position over a three-year period. The forecasts for 2024-25 are inevitably less reliable than the forecasts for 2023-24 (which themselves have a degree of uncertainty bearing in mind the extraordinary volatile economic environment). The Chancellor's Autumn Budget statement only set out spending plans for two years with detail only for the first year and substantial uncertainty how the high level spending plans for 2025-26 and later years will translate into individual departmental spending plans and the local government finance settlement. The most likely scenario is that any additional funding in 2025-26 will be substantially less than spending growth needed to maintain services at the current level and further significant savings are likely to be needed to continue to set a balanced budget.

2.14 In the medium to longer term the Council has to have a sustainable plan where spending growth is more closely aligned to Council priorities and available funding as the scope for savings without significant changes to legislative requirements is limited. The medium-term plan for 2022-25 was balanced (albeit with limited use of reserves in the first years). No plan, no matter how robust, could have foreseen the significant economic impacts of the global and national circumstances faced in the current year and it is unsurprising that there are significant variances from the original plan. What is important is how the Council responds so that there is greater agility in future without relying heavily on reserves. To this end it is vital that the Council continues to evolve financial planning taking an Outcomes Based Budgeting (OBB) approach that was started for 2023-24 (albeit that resource envelope approach agreed for building 2023-24 budget could not deal with the extraordinary circumstances witnessed during the current year). The experience from this year is also that the Council should not place over reliance on consumer and retail price indices for negotiating future costs of commissioned services.

Risk F – Impact on Reserves

2.15 The latest forecast for usable revenue reserves at the end of 2022-23 is £308.6m, this represents a substantial decrease of £99.5m on the position at the 1st April 2022. The forecast takes account of a drawdown of Covid-19 reserve, risk reserve, and other planned drawdowns from earmarked reserves as well as the amount needed to offset forecast overspends. In total the forecast drawdown from earmarked reserves is £102.4m, this is partially offset by a £3m increase in general reserves approved as part of 2022-23 budget to maintain these at 5% of net revenue budget. The reserves forecast includes draw downs to balance the year end position although this could change further during the remainder of the year.

Overall Assessment

2.16 The proposed budget represents a compromise between additional spending growth, spending reductions through savings, income losses and planned income generation, changes in reserves, government grants in the provisional settlement, the estimated council tax base, and proposed council tax charge increases. It is not the role of the S25 assurance statement to comment on the precise mix providing the overall package results in a balanced budget and the estimates on which the calculation is based are considered robust.

2.17 All the estimates within the proposed draft budget are the product of a comprehensive planning process with Cabinet Members, Corporate Directors and Directors resulting in an agreement on the level of service delivery within the identified financial resources. In addition, a separate appendix of the final draft budget sets out the main budget risks that are taken into account in determining the estimates.

2.18 The final budget includes the updated assessment of budget risks and adequacy of reserves taking account of the continuation of contingency provisions for demand and price risks, new contributions to reserves, and maintaining general reserves at 5% of the proposed 2023-24 net revenue budget. However, it also notes that variable/insecure funding is being used to balance the budget and that the Council's financial resilience is at considerable additional risk as it requires delivery of substantial savings and provision for uncertain forecasts for future cost and demand growth.

2.19 The budget strategy allows for a proposed draft budget which is affordable whilst allowing the Council to fulfil its statutory responsibilities and address local priorities. The proposed draft budget will require some difficult decisions about service levels and provision both in 2023-24 and over the medium term. These decisions will need to be confirmed under the Council's constitutional arrangements and Financial Regulations after due consultation and equalities impact assessments. It is essential that decisions are taken in a timely manner to achieve the amounts assumed in the proposed budget. As such the proposed draft budget is a plan which can be subject to change, with any changes considered and agreed by Cabinet through the in-year monitoring reports.

3. Conclusions

3.1 As Section 151 officer taking all relevant factors into account, I can formally report that in my view subject to all the measures set out in the draft budget and medium-term plan being implemented, the budget estimates are robust and the level of reserves adequate within the constraints in which the Council currently has to operate with funding not keeping pace with forecast spending growth, as required by the Local Government Act 2003. This is on the assumption that the proposed council tax increases up to but not exceeding the 3% referendum threshold and 2% for Adult Social Care levy are agreed. However, if the forecast outturn for 2022-23 is not brought down to a level that can be covered by reserves set aside for budget risks and stabilisation this poses a significant risk to the adequacy of reserves and thus the Council's financial resilience.

3.2 Council tax is now the most significant source of funding for council services. Any lesser increase than that proposed, without a corresponding reduction in base budget spending would have an adverse impact on the Council's financial resilience and ability to mitigate future spending risks or medium-term uncertainties over the future funding gap. This assessment has focussed on the significant uncertainty and volatility around spending and income forecasts for 2022-23 and that the Council has previously had adequate but comparatively less generous reserves for risks at the time.

3.3 The administration's revenue proposals for 2023-24 and medium-term plan are not without significant additional risks. The proposals strike a balance between affordability whilst allowing sufficient resources for the Council to fulfil its statutory responsibilities and address local priorities. This is not an easy combination and will require some difficult decisions about service levels and provision. It will require services to bear down on spending growth, particularly with regard to future price levels and managing demand. In my view whilst this presents risks, the Council currently has sufficient financial resilience and reserves , such that the additional risks are not excessive or reckless. However, it is essential that there is a relentless focus on financial and demand management, delivery of savings and income plans, timely decision making and there are not additional spending requests that would add to costs over and above budgeted levels. It is also essential that where variations from the budget plan are identified that remedial action is taken promptly to ensure a balanced budget can be delivered.

3.4 The proposed draft revenue budget includes a significant package of savings to balance forecast spending growth within the funding available from local taxation and government grants. As identified in this report it is essential that decisions on implementing these savings plans are taken in a timely manner if the amounts included in the budget plan are to be achieved. The forecasts for future spending growth are still considerably uncertain and will only be finalised in controllable budgets once uncertainties have been resolved. The amounts set out in the directorate plans are notional at this stage for comparative purposes.

3.5 The proposed 2023-24 budget includes an additional contribution to general reserves in line with the medium-term strategy to have the overall level at 5% of net spending to improve financial resilience. This level of general reserves is considered to be essential in light of increased financial risks, the increased self-sufficiency of councils and greater reliance on tax income, and medium-term uncertainties. Any drawdown from general reserves either as part of addressing the 2022-23 overspend or to cover variances from the proposed draft 2023-24 plan (which already includes £12.5m from Corporate and Public Health reserves to balance the budget) would require general reserves to be replenished back up to 5% level at the earliest opportunity, even if this requires delivery of additional savings from the proposed amounts identified for 2023-24 and 2024-25. Failure to maintain general reserves at 5% would in my opinion very likely seriously impair the adequacy of the Council's reserves and consequently its financial resilience.

3.6 The longer-term capital planning within the proposed 10-year programme delivers urgent and critical works as well as addressing the need to minimise new borrowing and deficiencies in previous plans that have led to significant rephasing. Both of these have significant consequences on future revenue budgets. The level of borrowing continues to be a concern, even though it has been reduced, sustainable alternatives urgently need to be identified.

3.7 Finally, I draw members attention to the known correlation between those councils which have had the lowest council tax rates, undeliverable savings plans, highest levels of debt, lowest levels of reserves and subsequent concerns about financial management. Whilst these are not the only factors which could give rise to financial management concerns, they remain an important consideration in the assessment of financial resilience and sustainability. KCC's current council tax charge is around the average of all county councils, but levels of debt are well above average compared to levels of reserves which remain below average. The levels of debt are slowly being addressed through the new 10-year capital programme and avoiding additional borrowing, but the Council also needs to maintain levels of reserves which reflect levels of council spending, financial risks and medium-term uncertainty.

Recommendations:

(a) Pursuant to section 25 of the Local Government Act, County Council is asked to CONSIDER and NOTE this report and AGREE to have due regard to the contents when making decisions about the budget.

3. Contact details

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