Budget risks and adequacy of reserves

The assessment of budget risks and the adequacy of reserves is even more important for 2024-25 initial draft budget and the medium-term plan due to the priority to restore the council's financial resilience as set out in Securing Kent's Future – Budget Recovery Strategy". The strategy recognises that the current in-year overspend on the scale forecast and the underlying causes from rising costs most notably in adult social care, children in care and home to school transport represent a fundamental risk to the council's ability to set a balanced budget for 2024-25 and a sustainable MTFP to 2026-27. Those risks are assessed in more detail In this section of the budget. In the circumstances 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. This section includes a new and separate assessment of the current position of the council against the key symptoms of financial stress identified by CIPFA in its report entitled "Building Financial Resilience".

The administration's initial draft budget and MTFP is informed by the best estimate of service costs and income based on the information currently available. Publishing the initial draft in November inevitably means these estimates are longer range and thus more likely to change for the final budget or when actual costs are incurred. It is also acknowledged that this does not come without risks particularly as the recent trends for changes in key cost drivers makes forecasting them accurately under traditional incremental budgeting very difficult and we have not completed the full transition to an Outcomes Based Budgeting approach (which in any case would not in itself completely remove the risk from cost drivers). 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 cost of providing key services and/or level of service demand 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 from the main cost drivers and in some cases from 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
- Claimants of Local Council Tax Reduction Scheme discounts

International Factors

- War in Ukraine and other conflicts causing instability
- 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

- **High Court ruling on Unaccompanied Asylum Seeking (UAS) Children** – the judgement that the council is responsible for supporting all UAS children arriving in the county until they are transferred under National Transfer Scheme impacts on the availability and therefore cost of carers for local children as well as risks of shortfalls in funding refugee schemes (see below)
- **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
- **Other delayed legislative reforms** – impact on council costs and ability to deliver savings/spending reductions e.g. Extended Producer Responsibilities
- **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 Costs and Demand

- Long term impact of Covid-19 pandemic on clients and suppliers
- Higher cost for new clients coming into care than existing clients especially but not exclusively older persons residential and nursing care and children in care
- Adult Social Care demography from increased complexity
- Children's Social Care including sufficiency of Foster carers and numbers of UAS children 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 direction of travel for this indicator was showing as deteriorating in last year's budget due to the historically high levels of inflation that arose during 2022. The annual rate of inflation (using CPIH) peaked at 9.6% in October 2022 and has been on a downward trajectory in the subsequent months (CPI peaked at 11.1% and RPI at 14.2% in October 2022). The March Office for Budget Responsibility forecasts were for the rate of inflation to peak in quarter 4 of 2022 (CPI 10.7% in quarter 4 2022), before the rate of prices growth falls back reducing to 9.7% in quarter 1 2023, 6.9% quarter 2, 5.4% quarter 3, 2.9% quarter 4 and 1.5% quarter 1 2024. However, the rate of inflation in 2023 has not reduced as much as the March 2023 OBR forecast with reported CPI from Office for National Statistics (ONS) of 10.2% quarter 1, 8.4% quarter 2 and 6.7% quarter 3. Revenue spending subject to inflation is around £1.4bn so each 1% adds £14m to council costs. One of the principal reasons that inflation is not falling as much as forecast is due to the rise in petrol and diesel prices amid a sharp rise in in global oil costs over recent months offsetting falls in food price inflation. The higher than forecast inflation is the reason why this measure is still showing as deteriorating for 2024-25 as it makes the impact on future price forecasts in budget plans uncertain and volatile.
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 mixed with the rise in interest rates dampening large new-build housing developments. Although there is a reasonable pipeline of assets for disposal the risk profile for potential delays remains high therefore leading to a continued deterioration in this measure.
Capacity to manage in-year budget pressures and strategy for dealing with demand and service delivery in the longer term	↓ ↓	2022-23 ended with a revenue budget overspend for the first time in 23 years. The net overspend in 2022-23 was £47.1m after roll forwards (3.9% of net revenue). Overspends before roll forwards were reported in Adult Social Care & Health (ASCH) of £24.4m, Children, Young People and Education (CYPE) of £32.7m, Growth Environment and Transport (GET) of £0.9m, Deputy Chief Executive Department (DCED) of £1.6m. These were partly offset by underspends in Chief Executive Department (CED) of £3.5m and Non-Attributable Costs and Corporately held budgets (NAC) of £11.8m The most significant overspends were: • £30.5m older persons residential and nursing care in ASCH • £16.1m home to school transport in CYPE • £9.9m children in care in CYPE The most recent 2023-24 revenue budget monitoring presented to Cabinet on 5th October 2023 showed a forecast overspend of £37.3m before management action. This overspend was largely driven by higher spending growth than the £182.3m (excluding spending on externally funded activities) provided for in the budget. The largest overspends are in the same main areas as 2022-23 (adult social care, children in care and home to school transport). This is despite including additional spending in the budget for the full year effect of recurring spend from 2022-23 and forecasts for future price uplifts, increases in demand and cost increases unrelated to price uplifts. At the same Cabinet meeting on 5th October 2023 a separate report “Securing Kent’s Future – Budget recovery Strategy” set out the broad strategic approach to providing reassurance on the necessary action to bring 2023-24 budget back into balance and the opportunity areas for further savings and avoidance of future cost increases over the medium term 2024-27. However, until this strategic plan has been converted into detailed plans and these have been delivered managing in-year spending and spending growth over the medium term presents the most significant risk to

		the Council's financial resilience and sustainability and therefore the highest rating of deterioration. .
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 as a result of overspends. However, the ability to activate contingency plans if planned savings cannot be achieved has to date been severely restricted as a result of these overspends, although every effort is being made to reduce the forecast overspend in 2023-24. 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). A significant plank of the 2023-24 recovery strategy is to reduce non committed spending for the remainder of the year. At this stage it is expected that managers across the whole organisation will exercise this restraint to reduce forecast spending for the remainder of the year. However, if this does not result in sufficient reductions to bring in-year spending back into balance further spending controls will have to be considered. These spending reductions are largely anticipated to be one-offs and will not flow through into 2024-25 or later years. The increased focus on savings monitoring and delivery has had some impact and the majority of the overspend in 2022-23 and forecast for 2023-24 is due to unbudgeted spend rather than savings delivery, although savings delivery is still a contributory factor and remains a risk, this is no greater risk than in previous years, hence this measure has not been rated as deteriorating. However, if the further savings necessary to bring 2023-24 back into balance are not proving to be achieved this measure would need to be reassessed for future drafts.
Risks inherent in any new partnerships, major outsourcing		Partnership working with NHS and districts has improved. However, further sustained improvements are still needed to change the direction of travel.

arrangements, and major capital developments		Trading conditions for Council owned companies continue to be 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 although the planned spending to limit modernisation programmes to essential measures to ensure buildings are safe warm and dry has proved to be inadequate and the programme needs to reflect a realistic level of spend on the assets the council needs to sustain necessary functions. Despite the action taken to limit additional borrowing, a third of the capital programme is still funded by borrowing. Slippage within individual projects remains an issue leading to lower than planned spending in the short-term but potentially higher medium to long term costs due to inflation. This slippage defers borrowing rather than reducing it. The quarter 1 capital monitoring report showed a forecast net underspend on capital spending of £42.3m comprising net £8.2m increased spending on projects (real variance) and £50.5m reduction due to slippage. The real variance includes spending on grant and externally funded projects where funding has been announced after the capital programme was approved.
Financial standing of the Authority (level of borrowing, debt outstanding, use of reserves, etc.)	↓ ↓	The financial standing of the Council has weakened significantly as a result of the overspend in 2022-23 that was balanced by the drawdown of £47.1m from general and risk reserves (39% of general reserve and all of the risk reserve). Usable reserves were also reduced through the transfer of £17m from earmarked reserves to Dedicated Schools Grant (DSG) reserve as part of KCC's contribution the Safety Valve agreement with DfE in March 2023 (with further transfer of £14.4m planned for 2023-24). Overall, the council's usable revenue reserves have reduced from £408.1m at 31/3/22 (40% of net revenue) to £355.1m at 31/3/23 (29.8% of net revenue) with further reduction to £316.3m (24% of net revenue) forecast for 31/3/24.

This forecast assumes 2023-24 revenue budget is brought back into balance by year end with no further draw down from reserves.

The reduction in usable reserves has significantly reduced the council's ability to withstand unexpected circumstances and costs, and reduced the scope to smooth timing differences between spending and savings plans. The levels of reserves now pose a more significant risk to the council's financial resilience than levels of debt. Levels of reserves are now considered to be the second most significant financial risk after capacity to deal with in-year budget pressures. Reserves will need to be replenished at the earliest opportunity and will need to be factored into future revenue budget plans.

The Council has an ongoing borrowing requirement of £1.1bn arising from its historic and ongoing capital expenditure, which is expected to remain broadly stable over the medium term. Most of this requirement is covered by existing external debt, which is forecast to decline gradually over the medium term (from around 72% in 2023/24 to 66% in 2026/27. The remaining portion is met via internal borrowing (namely the temporary use of internal cash balances in lieu of investing those balances with external counterparties).

Although the Council has been protected to a significant extent from the material increase in interest rates over the past two years (given that the majority of its borrowing requirement is already met by fixed rate debt) the higher rate environment has increased the expected costs of internal borrowing as well as costs associated with any new external borrowing over the near and medium term.

A small portion of the borrowing requirement (8.4% in 2023/24) is met via "LOBO" (Lender Option Borrower Option) loans. These instruments provide lower cost financing in exchange for giving the lender the periodic opportunity to reset the loan's interest rate. The Council manages the risks around these loans being "called" by restricting their use to only a minor portion of the borrowing portfolio and by avoiding any concentration in the loans' associated option dates.

In managing the structure of its borrowing (the balance between internal and external borrowing, and the portion of the latter that is made up of fixed-rate as opposed to variable-rate loans), the Council is chiefly concerned with risks arising from uncertainty around

		interest rates as well as ensuring it has adequate liquidity over the medium term. The Council reviews its borrowing strategy formally on an annual basis to ensure its approach remains appropriate.
The Authority's record of budget and financial management including robustness of medium-term plans		The direction of travel for this factor was shown as deteriorating in the final budget presented to County Council on 9th February 2023 due to the quarter 3 monitoring for 2022-23 showing a significant £53.7m forecast revenue overspend. The overspend reduced a little by year-end to £44.4m before roll forwards (£47.1m after roll forwards). However, this was not sufficient to change the direction of travel bearing in mind the scale further of the forecast overspends for 2023-24. The most significant cause of the overspends is higher than budgeted spending growth despite significant increases already factored into the budget. The need to include for the full year effect of current year overspends as a variance to the published medium-term plan means that the capacity to manage in-year budget pressures (highest rated risk assessment) is the most significant factor in MTFP variances rather than robustness of MTFP forecasts. This is the only reason that this particular assessment has not been shown as a significant deterioration with a double arrow. Nonetheless, the robustness of forecasts included in the MTFP does need improvement (hence this assessment is still showing a deterioration until these are improved). The initial draft budget for 2024-25 and MTFP for 2024-27 is not balanced. As outlined in the budget report this was an acknowledged risk from the earlier publication of the draft for scrutiny. At this stage the unbalanced initial draft has not been taken into account in the assessment of this risk as there is a strategy agreed to bring future drafts into balance. Should that strategy not be successful this aspect would need to be reassessed as further deterioration in future drafts. .
Virement and year-end procedures in relation to under and overspends		The direction of travel for this factor was shown as deteriorating in last year's budget due to monitoring for 2022-23 forecast to overspend and ongoing issues with Whole Government Accounts. The forecast for 2023-24 is further forecast overspend and issues remain with Whole Government Accounts meaning there has not been sufficient progress to date to change the direction of travel on this assessment.

		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 was issued on the 4th September 2023, following confirmation that no further work was required on the Whole Government Accounts. The audit certificate for 2021-22 has not been issued due to the audit of the 2021-22 Whole Government Accounts being outstanding as the external auditors have prioritised the audit of the Council's 2022-23 accounts. The draft outturn for 2022-23 was reported to Cabinet on 29th June 2023 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 overspend of £47.1m was reported after roll forwards of £2.7m. The overspend was funded from a drawdown from earmarked and General reserves. The draft accounts for 2022-23 were published on 1st July 2023 and are still being audited. The audit is ongoing as there is still audit work to complete on group accounts and pensions.
The availability of reserves and government grants/other funds to deal with major unforeseen events	↓	As identified in the assessment of the financial standing of the authority the levels of usable reserves have reduced at the end of 2022-23 and are forecast to reduce further by the end of 2023-34. Furthermore, a number of significant risks remain unresolved (including at this stage balancing 2023-24 revenue budget) which could impact on reserves and the assessment of their adequacy if solutions are not found. The most significant risk to reserves in previous years has been identified from the accumulated and growing deficit on the DSG reserve largely from the overspending high needs support within the DSG. This has now been addressed over a number of years through the Safety Valve agreement with DfE. However, at this stage the Safety Valve agreement is a recovery plan that will be delivered over a number of years with spending on high needs support gradually bought back into balance with the available grant funding and the historic accumulated deficit cleared with contributions from DfE and local authority. However, this does not fully mitigate the risk as should the plan not be fully delivered there is a risk that DFE could withhold contributions and a residue deficit would remain.

		The reserves forecast includes the transfer to the DSG reserve of the local authority contribution for 2022-23 and a further forecast transfer for the local authority contribution in 2023-24. Provision is included in the 2024-25 initial draft budget and 2024-27 MTFP for the remaining local authority contributions. The DSG reserve forecast also includes the DfE contributions for 2022-23 to 2027-28. These contributions together with the recovery plan to reduce the in-year deficit on high needs spending would see the accumulated deficit cleared by 2027-28. However, resolving this aspect of risk to reserves does represent £82.3m over the term of the agreement of the authority’s resources which would otherwise have been available to mitigate other risks. A new risk has arisen during the course of 2023-24 following the high court order that the Council must take all possible steps to care for all Unaccompanied Asylum Seeking (UAS) children arriving in the county under the Children Act 1989, unless and until they are transferred to other local authorities under the National Transfer Scheme. The council is currently in negotiation with Department for Levelling Up Housing and Communities (DLUHC), Home Office and Department for Education (DfE) over a funding package to support compliance with the judgement. To date the offer is circa £9m which is insufficient to cover forecast costs for caring for UAS children for the remainder of 2023-24 which if not resolved would leave a forecast deficit and no offer has yet been made for 2024-25. This combination poses a major threat to the Council’s financial sustainability. Although this DSG risk has been addressed the risk of the requirement for further draw downs if the 2023-24 current year spend and gaps in 2024-25 initial draft budget and 2024-27 MTFP and the overall forecast level of reserves means the assessment of this risk cannot yet show an improvement and could be a further deterioration’ A register of the most significant risks is published as part of the initial draft 2024-25 revenue budget, 2024-27 medium term plan and 2024-34 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. These plans will be

		updated in the 2023 Autumn budget which is scheduled for 22nd November. The local government finance settlement only included individual grant allocations and core spending power calculations for 2023-24. The settlement did include council tax referendum levels for 2024-25 as well as the overall additional amounts for the main grants for 2024-25 but did not include individual authority allocations. Other departmental specific grants were not included in the settlement.. The Autumn Statement and 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. A further tranche of funding for the Market Sustainability and Improvement Fund for workforce reform for 2023-24 and 2024-25 was announced in July 2023. However, the inadequacy of medium to long term sustainable funding for adults social care remains, and the lack of certainty that the additional funding available in 2023-24 and 2024-25 will be baseline for subsequent years cause the assessment of this risk to remain as a neutral direction of travel at this stage. This can be reassessed following the 2023 Autumn Budget statement. 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 . 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 strength of financial reporting and ability to activate contingency plans, and even this is conditional on delivering the contingency plans to bring 2023-24 spending back into balance), the remaining ten are still deteriorating. In the case of capacity to manage in-year budget pressures and strategy for dealing with demand and service delivery in the longer term and financial standing of the Authority (level of borrowing, debt outstanding, use of reserves, etc.) the deterioration is now at a severe level and cause for serious concern. There are aspects of these deteriorations as well as number of the others that 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 substantially and severely 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 initial draft 2024-25 budget includes a £16.4m net increase from changes in contributions and draw down from reserves. This is largely for the to replenish the draw down from general reserves in 2022-23 over two years 2024-25 and 2025-26 and provision for the local authority contribution to DSG reserve under the safety valve agreement. A full reconciliation of all the changes to contributions and draw down from reserves for 2024-25 is available through the detailed dashboard of budget variations.