Appendix C - Assessment of Level of Reserves

1 Introduction

Reviewing the Council's level of reserves is an important part of the annual budgetary 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.
This budget amendment is no different	It is even more essential given the heightened risk of uncertainty now and in future years arising from the fallout of the Covid-19 pandemic.

2 Background

There are 11 factors to consider when assessing the adequacy of reserves	The Chartered Institute of Public Finance and Accountancy (CIPFA) recommend that 11 factors should be considered when reviewing the level of reserves (see section 6)
The adequacy of reserves is subjective	There is no formula approach to calculating the precise level of reserves to be held; it is a matter of judgement. It is the responsibility of the Council's Section 151 Officer.

3 Government Settlement

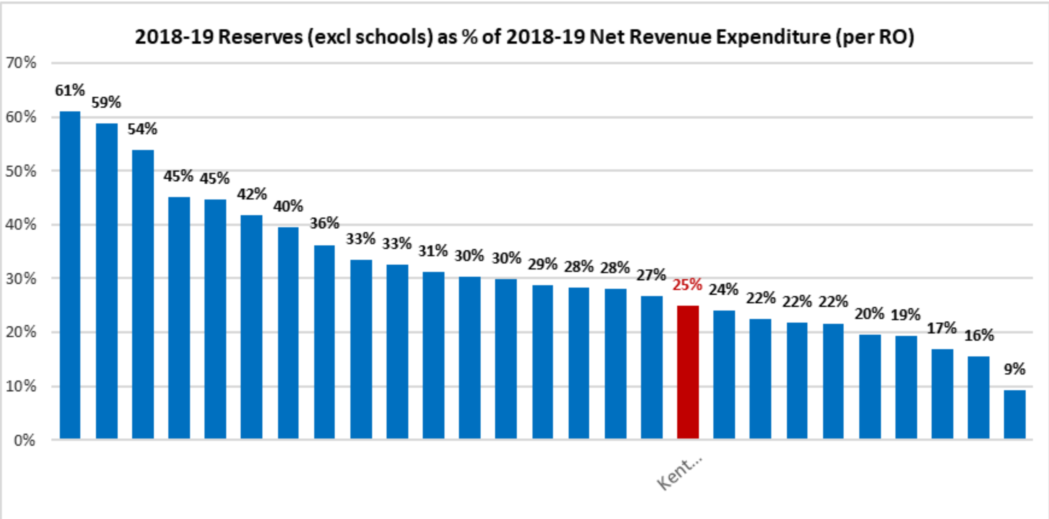
The government's original spending plans for 2020-21 were announced on 4 September 2019	For the sector as a whole this was a one-year settlement, with a repeat of 2019-20 grants plus an additional £2.9bn (6%) from Council Tax increases, inflationary uplifts to business rates and a £1bn grant to support social care spending pressures.
The final Local Government Finance Settlement was reflected in the 2020-21 budget presented to full Council on 13 February	The original assessment of reserves took account of the reduced risk from a better than expected 2020-21 settlement compared to the forecast in the 2019-22 MTFP, and the heightened medium-term uncertainty arising from only having a one-year settlement and potential changes in central government policy following the 12th December general election.
On 11 March the Covid-19 outbreak was declared a pandemic. On the same day the Chancellor announced the March 2020 Budget	The Chancellor's Budget was presented in two parts: - the immediate response to the emergency - the typical presentation of medium-term tax and spending plans
KCC received £39m in March as part of the immediate response to the emergency	The immediate response included the announcement of an initial tranche nationally of £1.6bn emergency funding for local authorities. KCC's share was £39m. £1.7m of this was used to fund expenditure in 2019-20 with the remainder transferred to a specific Covid-19 reserve to be used in 2020-21
Several subsequent grant announcements have been made but the medium term outlook is uncertain	These additional grants have helped to mitigate increased risks in 2020-21. However, subsequent years are even more uncertain due to the lack of government spending/provisional settlement and the risk to council tax and business rates collection fund and future tax base estimates from the recession caused by the

lockdown period.

The speed of economic recovery and the government's response to support local authorities will have a significant impact.

4 Comparison with other County Councils

The graph below shows that KCC ranks 18th out of 27 county councils in terms of the percentage of reserves held.	This is based on the same 2018-19 data as the original budget and updated data from 2019-20 will not be available until later in year. This is the same ranking from last year despite an increase in the overall reserves of £27.6m compared to 2017-18.
Reserves comprise general reserves for unforeseeable circumstances and earmarked reserves for specific eventualities	Total reserves have been relatively stable at an average of around £200m in most years and £223.5m on 31 March 2019 (25%) but this is below the average of other county councils KCC has used some of its earmarked reserves to support the revenue budget in recent years but has also been able to set aside additional reserves to offset higher financial risks, particularly in 2018-19 from better than expected additional business rates income from the retention pilot and roll-forwards approved at the end of the year.



The graph above shows the lowest Authority at 9%, up to the highest at 61%. KCC is at 25%	This figure of 25% is made up of the General Fund Reserve of £37.1m (around 4% of net budget) and Earmarked Reserves (including Public Health and trading surpluses but excluding Schools, Capital Receipts and Capital Grants unapplied) of £186.4m, totalling £223.5m. Details can be found in the 2018-19 Statement of Accounts, in Notes 23 and 25.
Reserves must be considered alongside borrowing to form a complete picture of financial resilience	Capital spending can be funded from borrowing to protect reserves, but reserves can also be used to reduce the need for borrowing.

The graph below shows the percentage reserves to percentage debt ratio. KCC is ranked 21st out of the 27 Counties.

This year the calculation has changed to include other long-term liabilities as well as borrowing to be consistent with the gross external debt position used by CIPFA in their Financial Resilience index. This index is an analytical tool designed to provide councils with a clear understanding of their position in terms of financial risk. The index is made up of a set of indicators, which can be used to compare against similar authorities. As a result, the Council has moved from 20th to 21st in the rankings.

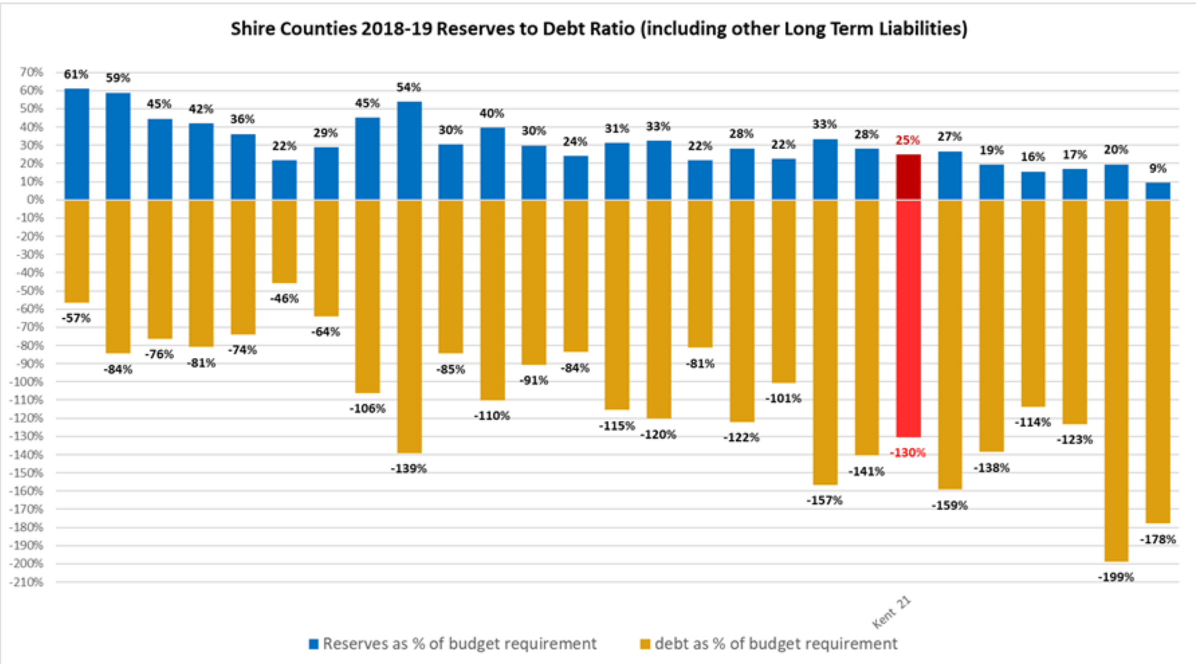
KCC has relatively high levels of historic external debt of £906.2m

Despite the Council's more recent approach to rely on internal borrowing, this position reflects KCC's historic external debt levels.

There is little that can be done in the short term

As most debt is long-term, with significant early repayment penalties far exceeding the benefits of redeeming the debt, this position is unlikely to change for some time. Whilst KCC has sufficient cash balances, the Council's current policy is to support capital spending with internal borrowing rather than external debt.

The continuing need to finance capital expenditure with borrowing presents a significant risk to the level of reserves and financial resilience of the Council.



5 Financial Resilience

There is a much greater emphasis from government on monitoring the financial resilience of councils

There have been well publicised financial difficulties in some councils. With the heightened risk of more councils getting into financial difficulties over the coming years, CIPFA has reviewed its range of guidance tools and services.

CIPFA has developed a Financial Resilience Index

The index is designed to promote better financial management and to provide early warning systems, aiming to be an authoritative measure of a council's financial resilience drawing on published information. The tool is not a

	performance measure of service outcomes or quality, nor a review of leadership but is a dashboard indicating warnings (not a full diagnostic tool). The financial resilience index is based on 2018-19 outturn. As with the comparison of reserves and debt this section is unchanged from the original approved budget as the CIPFA tool will not be updated until later in the autumn when the 2019-20 outturn information is available for all councils.

The Financial Resilience Index is based on 11 measures:

1. Reserves sustainability measure (the number of years it will take for a council to deplete their reserves if they continue to use them at the same rate as the average of the last three years)
2. Level of reserves
3. Change in reserves
4. Interest payable as a proportion of net revenue expenditure
5. Gross external debt
6. Social care ratio (proportion of net revenue spending accounted for by children's social care and adult social care)
7. Fees and charges to service expenditure ratio (sales, fees and charges as a proportion of gross service expenditure)
8. Council Tax requirement to net revenue expenditure ratio
9. Growth above baseline (the difference between the baseline funding level and retained rates income, over the baseline funding level)
10. Auditors VFM judgement
11. Children's Social Care judgement (Ofsted rating for children's social care)

The resilience indices will sit alongside the newly released CIPFA Financial Management Code	This will support good practice in the planning and execution of sustainable finances
KCC has recently commissioned CIPFA to undertake an evaluation of KCC's financial management arrangements	The conclusions and recommendations from the CIPFA Financial management Review will be considered as part of the 2021-22 budget
The current assessment is that the Council is not in imminent danger of financial failure	The Council is in the lower half of the resilience range, and therefore the Council cannot be complacent and must continue to maintain financial rigour. Whilst the risk of financial failure is not imminent, there is a need to remain vigilant, particularly in relation to accumulated debt and associated financing costs

6 Analysis of Risk

Below are each of the 11 factors CIPFA recommend should be considered when reviewing the level of reserves and balances is given a 'direction of travel' (DoT) indicator since the original 2020-21 budget was set.

An upward direction means an improved position for this council (i.e. the risk is less than it was at the time the original 2020-21 budget was approved).

The background for each of the 11 factors is provided as well as the analysis of risk

DoT	Heading	Background	Risk Analysis
↑	**Assumptions regarding inflation and interest rates**	Inflation has been on a general continual downward trend. At the time of budget setting for 20-21 it was below the government target of 2%. Since February 2020 and during lockdown inflation fell further. Despite a small rise in July 2020 as the economy started to recover, most forecasts predict inflation will remain well below the 2% target until mid-2022. Interest rates, largely determined by the Bank of England base rate, has been 0.75% since August 2018. In response to the pandemic, in March 2020 the base rate was reduced to 0.25% and then to 0.1%.	In the short term the lower forecast rate of inflation reduces the Council's risk. However, many of the Council's contracts are no longer index linked and market conditions in certain sectors are likely to have a significant impact on spending. In the longer term, inflation at or close to the 2% target and low interest rates result in a broadly neutral impact.
↓	**Estimates of the level and timing of capital receipts**	The Council relies significantly on capital receipts to part fund the capital programme. Delivery of receipts against targets has fallen behind in recent years requiring the use of short-term borrowing/use of reserves. Before the pandemic there were concerns about the ability to deliver the capital receipts needed to fund the current capital programme, and during lockdown market activity dried up.	The council is unlikely to catch-up for the lost time during the remainder of the current financial year. There is still a healthy pipeline of potential receipts and capacity to identify opportunities and monitor progress. This should ensure over the medium term that this risk can be reduced.
↓	**The capacity to manage in-year budget pressures and strategy for dealing with demand and service delivery in the longer term**	2019-20 was the 20th consecutive year that ended with a small net surplus. However, the first monitoring report for 2020-21 (and this budget amendment) includes significant additional demand led spending unrelated to Covid-19 pandemic. The amendment includes further proposed savings to offset spending demands and includes provision for further increased demand led costs during the recovery phase. The budget strategy for 2021-22 must include ways to resist some of the growth proposals, creating the need to identify budget savings and income streams to balance the budget.	There is an increased risk at this stage due to heightened uncertainty. It is likely that in future years there will be further demand led pressures which unless recognised in the Comprehensive Spending Review could become unaffordable. As each year passes it becomes harder to resist pressures or find savings/income and the council has less and less expenditure that can be de-commissioned at short notice.

→	**Strength of financial reporting and ability to activate contingency plans if planned savings cannot be delivered**	There is confidence in the validity of financial reporting. Reporting has been enhanced to better focus on the major factors affecting financial performance. Some progress towards enhancing outcomes-based budgeting within the Council has been made but there is scope for further development.	The council has engaged CIPFA to carry out an evaluation of compliance with the Financial Management Code as part of a wider review of financial Management. Once the review is completed this risk will be reassessed.
↓	**Risks inherent in any new partnerships, major outsourcing arrangements and major capital developments**	Partnership arrangements with NHS organisations have worked well during the pandemic with fewer hospital discharges into care than in other areas. Collaborative working with district councils has enabled improved assessment of the possible impact of the recession on future tax yields and collection fund balances, resulting in enhanced joint cashflow planning. The returns from the Council's trading companies have been severely impacted by lockdown and from a major cyber breach affecting Commercial Services.	The impact of lockdown on the council's trading companies has increased financial risk since the original budget was approved. The risk that retendering of major contracts could result in higher prices due to market conditions has also been impacted by the pandemic. Some contract retenders have been deferred, extending current contracts for a further period. There are concerns about the Council's ability to continue to sustain a capital programme tackling both statutory responsibilities and making infrastructure improvements. In the longer term these objectives cannot be delivered without an increasing reliance on borrowing.
→	**Financial standing of the Authority (level of borrowing, debt outstanding, use of reserves etc.)**	The budget amendment does not include any additional drawdown from reserves other than the Covid-19 emergency grant paid into reserves and the underspends agreed by Cabinet to be rolled forward into 2020-21. Good progress has also been made to review existing reserves in line with Local Authority Accounting Practice (LAAP) bulletin 99. Estimated reserves at the end of 2020-21 are largely the same (around £210m) as estimated in the original 2020-21 budget. The level of borrowing to support previous capital investments remains relatively high compared to other counties. Much of the accumulated debt is long term with only 15% due to mature over the next 5 years. In recent years the Council has been	Risk in relation to reserves remains unchanged. The overall level of reserves is more stable in comparison to other authorities, although they remain relatively low. The general financial health of the Council remains fairly static, however there is no room for complacency. The Council's ability to finance future capital spending from borrowing remains a significant concern. It has been confirmed that the Fair Funding review will not be implemented 2021-22, and thus the expectation that legacy debt is better reflected in the Local Government

		able to use cash reserves to support the capital programme (internal borrowing) rather than increasing external debt as this represented a lower overall financing cost.	Finance Settlement will not happen for at least another year.
	The Authority's record of budget and financial management including the robustness of medium-term plans	This continues to be effective resulting in twenty consecutive years of underspend including 2019-20. The additional funding for social care announced in the Spending Round, together with the continuation of the adult social care Council Tax precept for a further year has contributed towards funding rising social care demands and costs.	The ability to continue to deliver an underspend or a balanced budget becomes increasingly more difficult with rising demands and insufficient, short term funding. Until the Comprehensive Spending Review is completed, it remains unrealistic to publish a Medium Term Financial Plan although the Council's leadership continues to consider various medium term scenarios. There continues to be significant concern about the viability of social care funding and the sustainability of the market over the medium to long term.
	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 continues to have a good record of closing its accounts in a timely manner including agreeing rollovers for over and underspends.
	The availability of reserves and government grants/other funds to deal with major unforeseen events	The Covid-19 pandemic has substantially increased the risk that the Council will need to rely on the availability of government grants, and ultimately reserves to balance the budget. This severely compromises the financial resilience of the Council. Until the third tranche of emergency grant was confirmed in July, the Council had not identified sufficient available reserves to make up for the shortfall between additional Covid-19 spending requirements and income losses and available grant. There is overspending and an accumulated deficit on the High Needs Block of the Dedicated Schools Grant (DSG) relating to spend 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	Pending the outcome of the Comprehensive Spending Review there remains a significant risk that draw down from reserves will be needed to balance future budgets. This now poses the most significant budget risk. There is a significant risk in relation to the overspending and accumulated deficit on the High Needs Block of the Dedicated Schools Grant (DSG), which government needs to address.

		assessed for Education and Health Care Plans (EHCPs). 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 several other large county 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. They have also not provided satisfactory arrangements for the treatment of deficits. Another major concern in this area is the grant funding available to prepare for the transition from BREXIT or to deal with significant disruption in the event of a disorderly withdrawal at the end of the current transitional period. Whilst additional funding has been allocated to all councils, with extra funding for councils with major ports, this has not been sufficient for the Council to cover additional costs and without further funding these costs will need to be met from the Council's reserves. The long-standing issues of insufficient grant funding for unaccompanied asylum seeking children (UASC) and care leavers has been resolved for 2020-21 to some degree through enhanced funding rates. The historic position remains unresolved.	 There is a risk that the unfunded costs of BREXIT will have to be met using reserves. There is a reduction in the financial risk associated with asylum although the Council has recently identified that there is no more capacity to take additional UASCs with consequential non-financial risk.
	The general financial climate	The current Spending Round only covers 2020-21. There are no indicative government spending plans beyond this or the Local Government Finance Settlement for 2020-21. This severely limits the Council's ability to make meaningful medium-term multiyear financial plans. This shortening of medium-term financial planning horizons for local government is one of the reasons which has prompted the CIPFA resilience indices and the new Financial Management Code. 2020-21 is the first year since 2013-14 that the Council has been unable to produce meaningful multi-year plans	The uncertainty over the general financial climate has increased. The uncertainty will remain until the Government has announced the outcome of the Comprehensive Spending Review as well as any funding linked to future devolution arrangements for local government. The uncertainty has also increased due to the possible impact of lockdown and subsequent recession on business rate/council tax collection fund balances and future tax base estimates.

		as although spending trends can be forecast with sufficient accuracy, the delay to the Comprehensive Spending Review originally planned for 2019 means we do not have an accurate picture of likely funding. The delays to the Fair Funding Review and additional business rate retention means we can better predict the impact of CSR when it is announced but it will leave the issues which first prompted these reviews unresolved.	
	The adequacy of insurance arrangements	The Council's insurance policies were reviewed in January 2016, insuring the same levels of risk as previously, albeit at a higher premium. Since then the Council's exposure to risk and levels of insurance reserves have been reassessed and a higher level of excess has been accepted on some policies in return for a lower premium. Evidence to date is that this has reduced the net cost to the Council. This is unchanged from the original budget.	The risk remains unchanged.

Of the eleven factors, one has shown an improvement from the original approved budget in February, five have increased risks and five are relatively unchanged.

No weighting has been applied to the individual factors, but the general financial risk to the Council should now be regarded as significantly increased since February.

Only the general reserves of £37.2m (as at 31st March 2020) are available to the Council to offset any in-year overspends and these are largely unchanged from the previous year. However, these can only be used once.

The overall conclusion is that the Council has a significantly increased risk profile since the 2020-21 budget was approved, and on a like-for-like basis the Council will have a similar level of earmarked and general reserves available during the year. This is not an immediate cause for concern pending the outcome of the Comprehensive Spending Review and further assessment of spending growth estimates and council tax/business rates collection fund and tax base estimates. Whilst no immediate action is required, the Council's resilience will continue to be monitored and the trend will need to be reversed as much as possible in the medium term.

7 The detail of the Council's reserves

The Statement of Accounts that is produced each year details Earmarked Reserves and explains why these reserves are held	There will continue to be draw-down and contributions to these reserves in line with the patterns of expenditure anticipated when the reserves were created. The council's reserves policy and the reserves held are being reviewed during 2020-21 to ensure the policy and the reserves are held corporately to support the Council's strategic objectives.

The proposed amendment to the 2020-21 budget includes the following estimated drawdown from reserves. The revised estimated reserves at the end of 2020-21 remain around £210m.

- drawdown £21.8m from earmarked reserves from £6.2m underspends rolled forward from 2019-20 and rephasing the planned use of directorate and corporate reserves from 2019-20;
- net drawdown £37.3m from Covid-19 reserve

8 Role of the Section 151 Officer

The duties of the Council's Section 151 Officer include the requirement 'to ensure that the Council maintains an adequate level of reserves, when considered alongside the risks the Council faces and the general economic outlook'. **The reserves the council holds on 1 April 2020 are, in the opinion of the Section 151 Officer, adequate.**