APPENDIX C

LOCAL GOVERNMENT ACT 2003 – REPORT BY THE CHIEF FINANCIAL OFFICER ON THE ADEQUACY OF RESERVES AND ROBUSTNESS OF BUDGET ESTIMATES

1. INTRODUCTION

1.1 Section 25 of the Local Government Act 2003 requires the Chief Finance Officer and Section 151 Officer to formally report to Council as part of the tax setting report on the robustness of estimates and the adequacy of reserves. The Council is required to take this report into account when setting the Budget and Council Tax at its meeting on 22 February 2023.

1.2 In the context of its service and financial planning the Council's overall approach to risk management is to take appropriate action to mitigate risks, or ensure that sufficient contingency exists, so that service provision is not threatened by unforeseen financial problems during the financial year.

1.3 Making changes to service provision at short notice in order to resolve a budget problem can have undesirable consequences. These can include:

(a) damage to the Council's reputation and customer relationships if services are unavailable or delayed

(b) failure to meet agreed performance targets

(c) inefficiencies in overall service provision

(d) associated costs of reducing service provision, such as staff redundancies, when planning changes over a longer timescale would allow greater flexibility

(e) potential problems for partner organisations that are dependent upon Council financial support to achieve agreed goals.

1.4 To avoid such problems the Council manages its financial risks by ensuring that its annual budget represents a reasonable estimate of the costs of providing agreed service levels. It also holds appropriate balances and reserves so that resources are available to allow a managed and considered response should any significant variations or emergencies arise.

1.5 This report considers:

- The Council's financial governance regime
- The robustness of the budget
- Review of Earmarked Reserves
- Adequacy of General Fund balances.
- Financial Standing

2. FINANCIAL MANAGEMENT, BUDGETARY CONTROL, AND RISK MANAGEMENT

2.1 East Suffolk Council operates a comprehensive and effective range of financial management policies. These are contained in the Financial Procedure Rules, which form part of the Council's Constitution. This Constitution is available on the Council's website. The Financial Procedure Rules were reviewed and amended, and a revised set of rules were put in place for 2022/23.

These rules are constantly being evaluated and reviewed in the light of operational considerations and changing circumstances, and further amendments will be made in 2023/24.

2.2 The Council conducts an annual review of the effectiveness of the system of internal control and reports on this in the Annual Governance Statement.

2.3 The Council continues to implement effective risk management policies, identifying corporate, operational and budget risks and mitigating strategies.

2.4 The internal and external audit functions play a key role in ensuring that the Council's financial controls and governance arrangements are operating satisfactorily.

2.5 This is backed up by the review processes of Cabinet, Scrutiny Committee, and the Audit and Governance Committee.

2.6 East Suffolk has a good record of budget and financial management and is expecting a balanced position for April 2023 to March 2024. All relevant reports to Council, Cabinet, and Committees have their financial implications identified and the links to the Financial Sustainability theme of the East Suffolk Strategic Plan is outlined. Emerging budget pressures are kept under review during the year and this has been particularly important over the last three years with the financial impact of the Covid-19 pandemic, high inflation and the cost of living crisis. The Council's budget has been particularly volatile in 2022/23 as a result of these pressures.

2.7 Strategic risk management is embedded throughout the Council to ensure that all risks are identified, mitigated and managed appropriately. The Council's insurance arrangements are in the form of external insurance premiums and internal funds to self-insure some items.

2.8 Projects are subject to business case challenge on financial and risk matters and to reflect their importance in delivery of the East Suffolk Strategic Plan and achievement of Financial Sustainability.

2.9 Income assumptions, particularly on the Council's key income streams of Council Tax and Business Rates, are subject to continual review and are reported on a monthly basis on the Council's intranet.

2.10 It In October 2019, CIPFA published the Financial Management Code (FM Code), which provides guidance for good and sustainable financial management in local authorities and will provide assurance that authorities are managing resources effectively. The FM Code applies a principle-based approach which requires that a local authority demonstrates that its processes satisfy the principles of good financial management for an authority of its size, responsibilities and circumstances. Following on from the principles of the FM Code, there are 7 areas of focus, supported by a set of guidance standards against which Councils should be assessed.

2.11 Using these standards, and key questions within the guidance, the Chief Finance Officer carried out a self-assessment of current processes, procedures, and governance arrangements, which was reported to the Audit and Governance Committee in December 2021.

2.12 This self-assessment has rated the majority of standards to be fully compliant with no areas rated as non-compliant. Areas for further development were identified and the self-assessment will be revisited in 2023/24.

3. ROBUSTNESS OF THE 2023/24 ESTIMATES AND TAX CALCULATIONS

3.1 The Budget and Council Tax calculations for 2023/24 are based upon forecasts of expenditure, income and Council Tax revenues up to 31 March 2024, with some significant assumptions made in order to prepare these forecasts. When setting its Council Tax for 2023/24 the Council needs to be satisfied that these assumptions are reasonable. In order to ensure the robustness of the budgeting, the Council's budget process commenced in September 2022 and progressed with Cabinet's consideration of the MTFS in November 2022 and the draft Budget in January 2023. Scrutiny Committee considered this in January 2023.

3.2 All areas of budgets have been reviewed by Heads of Service. In addition, a number of budgets are subject to overall cross-service review, including the Council's employee budgets.

3.3 The pay award for staff from 1 April 2022 was agreed at a flat-rate increase of £1,925. Budget and MTFS estimates are for a 4% increase in 2023/24, a 3% increase in 2024/25, and a 2% increase for 2025/26 onwards Reflecting staff turnover, an in-year vacancy allowance of 4% of staffing costs is maintained. Inflation assumptions are based on CPI forecasts and actual experience in specific sectors. Both pay and general inflation represents risks to the Council's budget and MTFS in the current environment of high inflation and volatility.

3.4 Budgeted increases for fees and charges are based on three key principles: cost recovery, market value and inflationary increases. The budget also includes those increases that are set and proposed by Government. However, in setting fees and charges for 2023/24, the Council has also been mindful of the cost of living crisis and the ability to pay of the district's communities.

3.5 Although interest rates are still at historically relatively low levels, interest rates have increased rapidly over the past year in response to inflation concern, increasing investment returns to the Council. Security of the Council's cash is the over-riding consideration in setting its Treasury Management Policy Statement. During the year the Council constantly receives advice from its Treasury Advisors with regard to the creditworthiness of financial institutions.

3.6 Business Rates is a key income stream to the Council. Significant reform in the local government finance system which will include resetting Business Rates baselines has now been further deferred until 2025/26 at the earliest, although 2026/27 is more likely. Reset of the system and the establishment of new funding formulae is likely to result in the Council losing a degree of financial advantage under the current system, which derives from the fact that actual Business Rates income is above the baseline in the system which was set at a low level in 2013/14. Budgeted figures for rates income and Section 31 Grant in 2023/24 and 2024/25 are based on the 2023/24 NNDR1 return, with the 2024/25 including a £1m reduction in estimated Suffolk Business Rates Pool benefit to cover uncertainties associated with the start of a new valuation period using a provisional rating valuation list. The 2025/26 and 2026/27 forecast figures are rolled forward cash figures and include a further £1m reduction reflecting the potential of a reset of the system. 2023/24 shows a significantly improved position on Business Rates income and surplus income from Business Rates, over and above addressing the budget gap for next year, has been transferred to the Business Rates Equalisation Reserve. This amounts to £2.46m and increases the balance on this reserve to £17.5m as at 31 March 2024.

3.7 Council Tax income was subject to financial impacts as a result of the pandemic, but also not to the extent that was previously anticipated. To a large extent, the position on the tax base has returned to projected pre-pandemic levels.

3.8 The Council is required to complete a range of calculations (Prudential Indicators) to evidence that borrowing for capital expenditure is affordable, prudent and sustainable over the medium term. This makes sure that the cost of paying for interest charges and repayment of principal by a minimum revenue contribution (MRP) each year is taken into account when drafting the Budget and Medium Term Financial Strategy. The Council has a large and ambitious Capital Programme and external funding and the realisation of capital receipts will be important in ensuring affordability and delivery of the programme.

4. ADEQUACY OF RESERVES AND BALANCES

4.1 The Council holds a very significant value of funds in reserves and balances to enable it to plan and manage its finances soundly. In addition to the Council's General Fund which will have a balance of £6 million as at 1 April 2023, the Council's earmarked reserves are estimated to stand at around £42 million going into next year.

4.2 Main budget risks and sensitivity to the Council's key in-year income and expenditure variables in 2023/24 are referred to below:

- Cost of living crisis impacts, especially potential increases in homelessness and temporary accommodation costs
- Inflationary pressures, especially continuing high energy costs
- Uncertainty regarding business rates income relating to the 2023 revaluation
- Local government pay award levels

4.3 In response to risk, sensitivity, and uncertainty, the Council has continued to develop its prudent financial management arrangements, through the development of earmarked reserves. Broadly speaking, the Council holds earmarked reserves to:

a) Comply with statutory requirements or proper accounting practice;

b) To mitigate potential future risks or smooth year-to-year fluctuations in income or expenditure;

c) To earmark resources for future spending plans or potential liabilities.

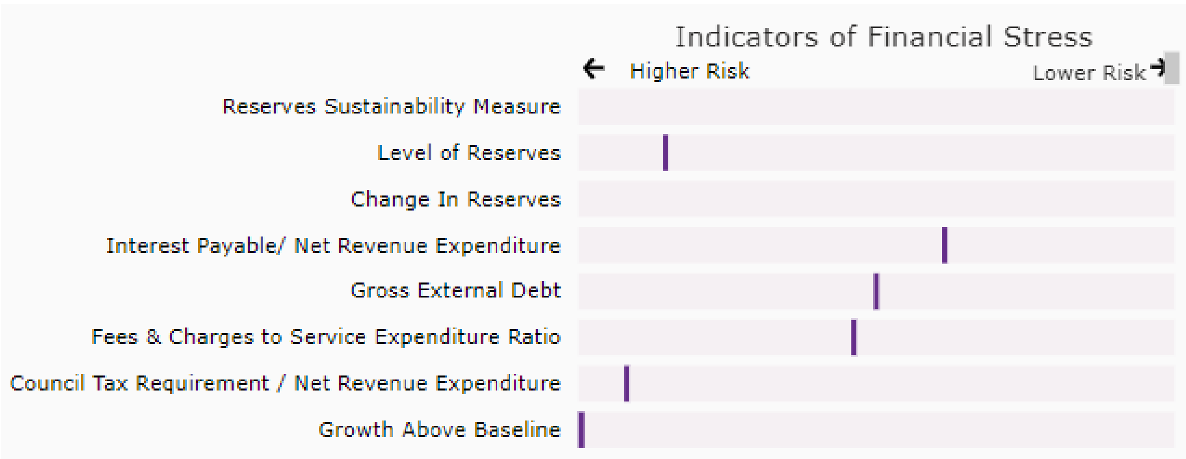
4.4 For the purposes of this report, around £13 million, principally in the Business Rates Equalisation Reserve, is available in category b) above, this This represents a very high level of coverage of risk and volatility in addition to the General Fund Balance.

4.5 As far as the General Fund Balance itself is concerned, the financial challenges and opportunities facing the Council over the medium term mean that the Council should continue to maintain a robust level of General Fund Balance of about 3% to 5% of budgeted gross expenditure, equating to about £4 million to £6 million.

5. FINANCIAL STANDING

5.1 As part of the consideration of the financial standing of the council, CIPFA provide a financial resilience index. This is a comparative analytical tool that may be used by Chief Financial Officers to support good financial management. The index shows a council's position on a range of measures associated with financial risk, compared with similar authorities across a range of factors. The index provides a useful snapshot of an authority's position, but needs to be treated with degree of caution for a number of reasons. Data may be inaccurate or incomplete for comparator authorities; the assessment of risk associated with an indicator may be open to different interpretations; and indicators may be misleading. Chief Finance Officers nationally continue to be in a dialogue with CIPFA as to how the Index can be improved.

5.2 The overall picture for East Suffolk as set out below based on 2021/22 outturn data is one of average or lower risk across the indicators. Overall, the Index gives no cause for concern, but does reflect some of the issues with the indicators referred to above. An example of this is that nearly all of the Council's Gross External Debt relates to HRA self-financing, whilst comparator authorities might not necessarily have housing stock. The only higher risk indicators relate to level of Reserves, Council Tax requirement proportionate to our net revenue expenditure, and Business Rates Growth above Baseline. Categorisation of reserves is subject to inconsistent treatment and reporting between authorities, an issue that DLUHC and CIPFA have undertaken to review next year, and the Council's level of reserves is likely to be understated in this indicator. Council Tax Requirement as a proportion of budget reflects the council's level of council tax, and other significant income streams, such as business rates and fees and charges. As council tax is a statutory charge, the interpretation in the Index is that councils are seen to have a greater financial resilience the higher the council tax requirement is as a proportion of net expenditure. This is a matter of opinion – arguably a lack of diversification of income streams and over reliance on one source could equally constitute higher risk. The Business Rates Growth above Baseline indicator has long been recognised as a risk – due to reset and reform of the system - in the Council's MTFS, hence the mitigation provided by the Business Rates Equalisation Reserve and cautious MTFS forecasts.



6. FUTURE YEARS BEYOND 2023/24

6.1 In recent years, the Council's financial position has been largely characterised by the fact that it has been in an advantageous position under the current Business Rates Retention system. Reforms to this system (and implementation of the Fair Funding Review) have been deferred on a number of occasions which has benefitted the Council and has enabled it to build up and maintain a robust Reserves position. This will be important in enabling the Council to adjust to pressures and uncertainties in the medium term and to address underlying budget gaps.

6.2 There are prospective activities not yet factored into the MTFS, which have the potential to make inroads into the budget gap towards the end of the MTFS. These include the Council Tax Premium on second homes, expected efficiencies from East Suffolk Services Ltd, and income streams from capital projects.

6.3 However, despite these factors, and the uncertainty due to local government finance reforms, the range and scale of expenditure and income pressures indicate that a combination of actions will be needed to ensure a longer term sustainable position including a phased use of reserves as referred to above, maximisation of income, and the achievement of savings.

7. CONCLUSION

7.1 Overall, the estimates are robust, taking into account known risks and mitigating strategies, and the reserves are adequate for the 2023/24 Budget plans.

Brian Mew (CPFA)

Chief Finance Officer and Section 151 Officer

February 2023