ANNEX A
REPORT OF THE CHIEF FINANCE OFFICER

COTSWOLD DISTRICT COUNCIL

1.1 Section 25 of the Local Government Finance Act 2003 places a statutory duty on the Chief Financial Officer to report to the authority, at the time the budget is considered, and the council tax is set on:

- the robustness of the estimates included in the budget
- and the adequacy of the financial reserves in the budget

1.2 The Act requires councillors to have regard to the report in making decisions at the Council's budget setting and council tax setting meeting(s).

1.3 The Council's Revenue Budget, Medium Term Financial Strategy and Capital Programme have been prepared with reference to the Chartered Institute of Public Finance and Accountancy's (CIPFA) guidance on prudential property investment. As Section 151 Officer, I have also had regard to CIPFA's Financial Resilience Index and the CIPFA Financial Management Code (FM Code).

1.4 CIPFA's Financial Resilience Index is a comparative analytical tool that supports good financial management and provides a high-level, common understanding within a council of their financial position based on a range of measures associated with financial risk.

1.5 The current Financial Resilience Index 2022 was published in December 2022 and is based on the outturn data for the 2021/22 financial year and has been influenced by the pandemic, increasing inflationary pressures and significant uncertainty affecting local authority funding.

1.6 Cotswold's highest risks on the Index are concerned with Earmarked Reserves, when compared to the Nearest Neighbour statistical group. Business Rates Growth above Baseline (i.e., the difference between the baseline funding and the level of business rates income) and the ratio covering Council Tax Requirement (i.e. the ratio of Council Tax as a proportion of net expenditure).

1.7 Measures concerning Council Tax Requirement / Net Revenue Expenditure (which shows the ration of council tax as a proportion of net revenue expenditure) and Growth Above Baseline (which shows the difference between the baseline funding level and retained rates income) scored above the average in the nearest neighbour group. Gross External Debt and Interest Payable (on the external debt) scored very low given the Council's capital financing position.

1.8 COVID-19 and the external economic environment have had an impact on the Financial Resilience Index, as the data is drawn from the Revenue Expenditure and Financing Outturn (RO) reports. CIPFA state that "it remains difficult to assess and predict the uncertain nature of how COVID, its legacy and inflationary pressures will impact local government. The pandemic has caused extraordinary financial costs to local government and the effects of inflation on council budgets, along with cost pressures, have continued to be felt into 2022/23 with little sign that these will ease."

1.9 The next release will cover the financial year 2022/23 and with the pressures on the Council's finances from the external economic environment measures around Earmarked Reserves can be expected to be an area of focus for the Council. Some Councils may have strengthened their reserve position. While the short-term picture based on the increases in reserves may appear to suggest that local government finances are sustainable, CIPFA remain concerned with the medium and longer term outlook, which largely remains unsettled, uncertain and more risky.

1.10 Paragraphs 5.4 to 5.5 of the 2023/24 Revenue Budget, Capital Programme and Medium Term Financial Strategy report outlines the compliance requirements of the CIPFA FM Code. Following a transitional year that encouraged Councils to demonstrate a direction of travel and a more proportionate approach regarding compliance with the Code, the Council should assess its position on full compliance. The s151 Officer will be reviewing this position utilising the FM Code's self-assessment tool with an Action Plan identifying actions required to address any areas of weakness.

1.11 CIPFA have outlined the four key areas to focus on in order to be financially resilient:

- Getting routine financial management right: financial systems and processes are working effectively
- Benchmarking: comparing costs, income and activity levels with similar authorities
- Clear plans for delivering savings: a single, consolidated, living document that sets out what savings have been agreed, progress in implementing the savings, with links to the budget and MTFS
- Managing reserves: clarity on the use of reserves between one-off and on-going demands

1.12 There are specific financial challenges being faced by a number of Local Authorities which have either issued Section 114 notices or have been the subject of specific Public Interest Reports. Section 114 notices are issued by the Chief Finance Officer when they believe Members have or are minded to approve an unbalanced budget where expenditure in a financial year is likely to exceed the resources available. Issuing the notice immediately suspends all financial activity apart from that which is necessary to maintain statutory duties. It also initiates a 21-day period for full council to consider the report and agree urgent action to start to remedy the situation. The authority's external auditors and the Department for Levelling Up, Housing and Communities (DLUHC) will also be notified and can step in to provide advice and support

1.13 CIPFA have also published a brief report (CIPFA Report on s114 notices) on learning the lessons from Section 114 notices. These used to be issued very rarely but members will note from that Croydon, Slough and Thurrock have issued such notices recently. It is worth stating the Council is not in financial difficulty and remains financially resilient, it is worth understanding the wider context. The main points include:

- The savings process should be effective and engaging, with budget holders actively involved in identifying and delivering savings.
- The risks around commercial activities must be clearly understood, with effective oversight of council-owned companies.
- Elected members must receive training on financial matters, improving their understanding of complex issues.
- Governance arrangements should be strengthened and include the ability to speak truth to power.
- Internal audit should review the effectiveness of financial rules and processes, and knowledge of and compliance with financial regulations.
- The quality of financial management should be assessed

Robustness of Estimates

1.14 The budget setting process at Cotswold District Council has been operating effectively over many years and have been prepared by appropriately qualified and experienced staff in consultation with management.

1.15 Service areas are required to undertake a review of service revenue budgets and work with the Publica Finance Team to produce detailed estimates for the forthcoming financial year. Proposed changes to service budgets are carefully reviewed, with consideration of savings and unavoidable budget pressures by senior management and Cabinet Members.

1.16 Budget Pressures have been reviewed, challenged and validated and only included in the MTFS where there is a clear business need or a wider strategic requirement to invest in service delivery.

1.17 Contract costs for Ubico and Publica are subject to significant cost pressures for 2023/24. Publica contract costs are forecast to increase by £0.400m in 2023/24. Ubico contract costs will increase by over £1m (around 14.7%). This is a mix of inflationary cost increases (Pay, Fuel costs) and revisions to service costs reflecting changes in waste streams and volumes.

1.18 Energy costs have increased significantly since the start of the financial year with the conflict in Ukraine leading to unprecedented increases in the wholesale energy market. Whilst prices have stabilised over the last few months as a result of Government support and reduced pricing in wholesale markets, it is difficult to forecast with certainty energy budget requirements for 2023/24. Inflationary provision of £0.300mhas been included in the revenue budget.

1.19 In recognition of the uncertainty around inflationary pressures on energy costs and major contracts and additional risk allowance has been included in the revenue budget of £0.200m.

1.20 The Revenue Budget, Capital Programme and MTFS have been subject to scrutiny through the Council's Overview and Scrutiny Committee. The Annual Capital Strategy and Annual Treasury Management Strategy and Non-Treasury Investment Strategy have been subject to review through the Council's Audit Committee

1.21 Financial management remains robust as demonstrated by the quarterly Financial, Council Priority and Service Performance Reports that are considered by Cabinet and the Overview and Scrutiny Committee. The outturn position (due to be reported in June or July 2023 subject to completion of the outturn process)

1.22 It is important that the council is able to balance the budget over the medium term in a sustainable and manageable way through a combination of income, sensible and prudent use of reserves and a robust cost reduction and savings programme.

1.23 The newly formed Cabinet Transform Working Group (CTWG) will adopt a revised approach to the Savings Programme to address the budget gap identified in the MTFS. CTWG will agree a revised process for how savings are identified, evaluated, and approved, with clear reporting and monitoring and governance arrangements.

1.24 As can be seen from Section 5 of the report, the requirement to reduce costs and balance the budget are substantial. The MTFS includes significant contract savings from Publica and Ubico over the next three years. There is clearly a risk associated with delivery of these savings. Should savings not materialise at the level or within the timeframe assumed this will increase the pressure on the Council balances and reserves. The Council will need to identify the specific risks within the savings programme and take steps to minimise this risk.

1.25 The basis on which the budget for 2023/24 and the MTFS have been prepared has been set out clearly in this report. I am satisfied that the budgets for the General Fund and the Capital Programme have been based on sound and reasonable assumptions.

<u>Risk</u>

1.26 As indicated in Section 8 of the report, there are a number of financial risks that the Council will face over the medium-term. The 2023/24 Budget and the MTFS have been prepared with consideration of these risks, but as with any forecast, an inherent level of risk will remain.

1.27 The first key risk is around the nature and scope of local government funding from the Government in 2024/25 and more substantially from 2025/26. The implementation of the Fair Funding Review and Business Rates changes has already been delayed (originally due from April 2020) and is likely to be reviewed following comments from the Secretary of State in November 2021. The forecast impact on District Councils is likely to be significant as resources are moved around Local Government to recognise Social Care cost pressures.

1.28 It is very difficult to estimate with certainty the impact on Cotswold. Fundamental changes to the way in which each Council's needs are assessed and funded are difficult to model despite some engagement from Government with local authorities. Therefore, considerable risk and uncertainty remains in the estimates for 2024/25 and beyond.

1.29 An initial estimate of a 30% reduction in the level of retained business rates income has been included in the MTFS assumptions from 2025/26. An estimate has been made around transitional arrangements, but these are not based on any indication or commitment from the Government but have been based on financial modelling provided by Pixel including a view on damping (transitional arrangements upon implementation of the new distribution methodology to avoid significant step-changes, shocks or disruption to stable financial planning and service delivery).

1.30 A significant uncertainty in the MTFS is the assessment of when funding changes will be implemented. The implementation of Local Government Finance reform has already been delayed several times. The Local Government Finance Policy Statement and subsequent settlement provided information on funding for 2024/25. Whilst no indication has been provided for future settlements, there a number of factors that may influence the timing of reform.

- General Election – if a general election is called as late as November 2024, there would only be a very short period for any new Government to consider reform and consult with Local Government on the 2025/26 settlement. This may mean reform is delayed until 2026/27.
- Business Rates Valuation periods – HM Treasury's final report on the Business Rates Review moved to more frequent valuations with April 2023 being the start of a 3-year valuation period. With the next valuation period commencing in April 2026, there may be some benefit to aligning Local Government Finance reforms with the new valuation period.

1.31 The second key risk is around the continued impact on the Council from pressures within the wider economy including inflation and interest rates. This will have an impact on income and expenditure budgets during 2023/24 and will require timely and accurate financial reporting to Cabinet. These risks include:

- Income from Council Tax and Business Rates will continue to be under pressure in 2023/24 with an expectation that the taxbase for Council Tax and Business Rates may take time to recover.
- Increased demand for certain services (e.g., Homelessness) may put additional financial pressure on the Council
- Cost of services where the Council is exposed to risk sharing in contract costs
- Energy cost pressures and the wider inflationary impact on costs and income

1.32 The budget has been prepared in light of key financial risks facing the Council over the medium- term, principally:

- Business Rates Retention and changes to the Local Government Finance system/Levelling Up Agenda
- Replacement of New Homes Bonus from 2024/25 at a time this Council will be continuing to delivering a significant number of new homes

Adequacy of the Reserves

1.33 The Balances and Reserves Strategy review has set a target for the General Fund balance to be maintained at a minimum of £1.760m, with the Financial Resilience Reserve balance held at a level that would allow the Council to mitigate short-term fluctuations in income and expenditure (e.g., Business Rates, Government funding changes). Given the budget gap identified over the MTFS period, the Council must identify and deliver new savings to ensure this reserve is replenished.

1.34 A number of earmarked reserves are held for specific purposes and to support the delivery of programmes in-line with the Council's priorities and to mitigate risk across the Council's budgets. Paragraphs 5.10 to 5.24 of the report set out the detailed position on the Council's balances and reserves.

1.35 The Council actively increased the level of balances and reserves it holds over the preceding years in recognition of the risks outlined earlier in the report. This does provide the Council with options and flexibility in its approach to addressing the financial challenges over the medium-term.

1.36 It is acknowledged that the remaining impact from Covid-19, cost and income pressures due to the external economic environment, and delivery of the Council priorities has placed pressure on the General Fund Balance in the short-term with planned deployment of the reserve in 2022/23 and 2023/24 of £2.108m. However, it is not sustainable or prudent to rely on the MTFS Equalisation reserve over the medium-term.

1.37 The establishment of the Financial Resilience Reserve is intended to ensure a minimum risk-based balance can be maintained on the General Fund Balance whilst recognising the requirement to support the MTFS (mitigating the budget gap) over the medium-term as CTWG work through a comprehensive Savings Programme.

1.38 The Council plans to maintain a balance of £1m in the Council Priorities Fund by the end of the 2022/23 financial year.

1.39 The Council has utilised Capital Receipts to finance capital expenditure with the balance on the Capital Receipts Reserve forecast to be £7.2m at the end of 2022/23. As shown in the Capital Financing Statement in Section 7 of the report, the Council will fully utilise the remaining balance to support the Capital Programme over the MTFS period. Without further capital receipts the Council will require prudential borrowing in future years to finance capital expenditure.

1.40 Whilst the level of balances and reserves shown in Table 10 of the report indicates that the Council is in currently a good financial position, the cumulative budget gap of £5.926m over the MTFS period would reduce the Financial Resilience Reserve to a nil balance during 2026/27. This will need to be addressed over the coming months as the Council will need to make significant decisions on future mitigation options

1.41 The Council continues to hold other reserves for specific purposes in accordance with decisions taken by Council in previous years. These will be kept under review during the financial year to ensure reserve balances held remain appropriate and adequate.

1.42 Therefore, I am satisfied that the level of reserves the Council holds for the forthcoming year is adequate to support the budget although members should consider the level of reserves utilised in 2023/24 and the need to ensure reserves remain adequate over the medium-term.

1.43 In conclusion, I am able to advise Members of the robustness of the estimates and the affordability and prudence of capital estimates for 2023/24. The level of reserves remains adequate to support the 2023/24 financial position and demonstrates financial resilience. However, this is only the case provided that action is taken to ensure that the balances are set at the level of £1.760m for 2023/24 and that all savings proposals, are monitored closely and delivered as planned.

David Stanley
Deputy Chief Executive and Section 151 Officer

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