

Potential for Merger of Cumbria and Lancashire Police Authorities An updating Report from the Treasurer

1. Financial Information and Assurances

1.1 The Home Office has now confirmed in writing the basis of a formal offer of grant in support of a merger of the Cumbria and Lancashire Police Authorities. The offer reflects intensive discussion between Officers of both Authorities and Constabularies and Senior Officials at the Home Office over the course of the past month culminating in a Home Office meeting on Monday of this week with both Constabularies' Directors of Finance. Even now, further representations have been made to seek an improvement on the offer, following discussions between both Authorities and Constabularies on Tuesday evening. It is hoped to have a response to these latest representations in time for the meeting.

1.2 The attached Appendix captures in summary form the most important aspects of the financial adjustments made by the Home Office to the Business Case submitted by the Constabulary in December and the recent offer of grant support. These matters must be considered by members in coming to a conclusion as whether this gives sufficient confidence to volunteer for merger with Lancashire Police Authority.

2. Business Case

2.1 The Cumbria business case (along with all other business cases) has been reviewed by consultants acting for the Home Office. On the basis of that scrutiny the Home Office have adopted a number of changes which reflect their view that a merger can be achieved for a set-up cost of £19.6m compared to the figure of £21.4m in Cumbria's business case submission and Lancashire's of £19m submitted earlier in the development cycle. The Home Office also estimate a higher level of ongoing annual savings at £7.3m per annum (Cumbria had estimated £4.8m and Lancashire £5.2m).

2.2 The main changes are as follows:

Set-up costs:

Original business case	£21.4m
Increase in Project Management	+£1.5m
Removal of retention bonuses	-£0.9m
Adjustment to redundancy costs	-£0.4m
Removal of contingency	<u>-£2.0m</u>
Revised set up costs	£19.6m

Ongoing annual savings

Original business case	£4.8m
Reduction in employee costs to reflect 5% savings in headcount	+£2.3m
Increase in savings on Supplies and Services (to equate to savings of 2.5% of total expenditure)	+£0.1m
Rounding	<u>+£0.1m</u>
Gross ongoing annual savings	£7.3m
Less provision for protective services	<u>£4.1m</u>
Revised ongoing annual savings (net of Protective Services)	£3.2m pa

2.2 Whilst it is disappointing that the costs identified in the Business Case have been reduced in this way, it is worth briefly examining the impact. On the face of it, the most serious reduction is the removal of the £2m 'contingency' – a provision which is suggested as essential under Treasury green book guidance for such projects to reflect risk and uncertainty. The Home Office appear to have satisfied themselves on the level of risk and uncertainty and may well be taking added comfort from the margin of £3.2m ongoing net savings after providing for an annual investment of £4.1m in level 2 policing, as representing an effective contingency against unforeseen expenditure. There is also some comfort to be taken from the decision to add back an additional £1.5m in project management costs to provide resources for greater direct and expert management of the merger and ICT projects in addition to the sums included within the original submission. This should help lessen the risks associated with the merger process. The Chief Constable of the new constabulary will need to be satisfied that the 5% saving in non-police headcount can be achieved without impacting on the necessary level service in a merged Authority.

3 Financial Support towards Set-up Costs

3.1 I emphasised in my earlier comments that any merger would be critically dependent upon government financial support to address the set-up costs. I also advised that the Home Office had set aside national funding of £50m in 2006/07 and £75m in 2007/08 from the annual capital grants programmes. Following discussions and representations over the past month but more critically in the past week, a formal offer of support has now been received.

3.2 The offer is intended to be firm in the sum of £10.9 modelled upon 100% capital grant for expenditure phased to be incurred in 2007-08 and 50% of that to be incurred in 2008-09 together with 50% of revenue set-up costs to be incurred in 2006-07 and 2007-08. However this latter revenue element worth approximately £4.6m out of the £10.9m is only available if the two Authorities volunteer for merger on a 'pathfinder' basis.

3.3 This offer is based upon the Home Office assumption that the redundancy and associated set-up costs will likely have to be treated as revenue expenditure

and so will attract only 50% funding under the pathfinder element of the offer. If in the (perhaps unlikely) event that permission is given to treat these costs as capital expenditure, then the grant offer would increase to £13.9m because the costs would then attract the 100% capital grant funding available in 2007-08, compared to the 50% available by way of pathfinder revenue grant.

3.4 Arising from our discussions with Lancashire on Tuesday evening further representations have been made to the Home Office that more certainty is needed and suggesting that they should agree to increase the capital grant by a further £3m (as in the second model) rather than be subject to the uncertainty of the accounting treatment of the redundancy costs which will not be determined for some time. If they agree to this course the two Police Authorities would need to manage the funding of their committed capital programmes for 2005-06 and 2006-07 in such a way as to substitute some 'borrowings' for the use of revenue resources and so release additional revenue resources to the new Authority to cover revenue set-up costs. A response to this proposal has been requested before the meeting on Friday. In exploring this option, Cumbria's capital programme for 2005-06 is to be partly funded by £1.5m of revenue sourced funds and the approved capital programme for 2006-07 by £3.6m. In essence the new Authority would take on (for example) up to £5m of additional borrowings from Cumbria and no less than an additional £5m of revenue based resources which could then be applied in meeting the revenue based set-up costs for which a borrowing approval would not otherwise be available. It would be a matter for the new Authority as to whether any such borrowings were repaid from the net savings which became available following the amalgamation.

4 Future Annual Financial Settlements

4.1 Concern was expressed by Cumbria Police Authority, as by many others, on the on the newly introduced spending assessment and grant distribution formulae for Police Authorities in advance of merger arrangements for strategic authorities. The Home Office has confirmed in its letter that it expects to start work later in the year on a review of the impact of the funding and distribution formulae and the establishment of Strategic Police Authorities with an expectation of new arrangements in time for the first of the three-year settlements in 2008-09.

5. Harmonisation of Precepts

5.1 Given that ODPM have primacy in this matter it is unlikely that any further information will be available by Friday, although it is a matter on which the Authority should expect to see progress during the discussion period before any Order is laid, if the Authority decides to volunteer for merger with Lancashire.

Douglas Thomas

Treasurer

23 February 2006

Cumbria Police Authority

Summary of Financial Considerations re merger of Cumbria and Lancashire Police Authorities

Business Case for Merger			Home Office Projected Annual Cash Flows					
Cumbria Submitted	Home Office Changes	Home Office Approval		Year 0 06-07	1 07-08	2 08-09	3 09-10	4 onwards 10-11
£m	£m	£m		£m	£m	£m	£m	£m
			Capital Set-up Costs					
7.60		7.60	ICT projects					
1.68	0.92	2.60	ICT Project Management					
<u>-2.00</u>		<u>-2.00</u>	Less Committed Funding					
<u>7.28</u>	<u>0.92</u>	<u>8.20</u>	Total Capital Set-up Costs		4.53	3.67		
		<u>-6.35</u>	Grant based on expenditure profile		<u>-4.53</u>	<u>-1.82</u>		
		<u>1.85</u>	Net Capital Cost to Merged Authority		<u>0.00</u>	<u>1.85</u>		
			Revenue Set-up Costs					
11.03	-1.30	9.73	Employees					
0.00	0.58	0.58	Project Management					
0.43		0.43	Premise, Transport					
0.77		0.77	Supplies and Services					
1.95	-1.95	0.00	Contingency					
<u>0.00</u>	<u>-0.11</u>	<u>-0.11</u>	Starting point adjustments					
<u>14.18</u>	<u>-2.78</u>	<u>11.40</u>	Total Revenue Set-up Costs	0.40	8.87	1.86	0.27	
		<u>-4.63</u>	Grant based on expenditure profile	<u>-0.21</u>	<u>-4.42</u>	<u>0.00</u>	<u>0.00</u>	
		<u>6.77</u>	Net Revenue Cost to Merged Authority	<u>0.19</u>	<u>4.45</u>	<u>1.86</u>	<u>0.27</u>	0.00
21.46	-1.86	19.60	Total Set-up Costs	0.40	13.40	5.53	0.27	
		<u>-10.98</u>	Total Grant - minimum guaranteed	<u>-0.21</u>	<u>-8.95</u>	<u>-1.82</u>	<u>0.00</u>	
		<u>8.62</u>	Net Cost to Merged Authority	<u>0.19</u>	<u>4.45</u>	<u>3.71</u>	<u>0.27</u>	<u>0.00</u>
			Annual Ongoing Costs and Savings (-)					
-3.92	-2.30	-6.22	Employees (net)					
-0.85	-0.10	-0.95	Supplies and services					
<u>-0.03</u>	<u>-0.10</u>	<u>-0.13</u>	Rounding					
<u>-4.80</u>	<u>-2.50</u>	<u>-7.30</u>	Gross ongoing annual savings		-3.20	-6.10	-6.40	-7.30
0.00	4.10	4.10	Level 2 Policing (from year 1)		4.10	4.10	4.10	4.10
		<u>-3.20</u>	Annual Cashflow Cost or Savings (-) net of L 2 Policing		<u>5.35</u>	<u>1.71</u>	<u>-2.03</u>	<u>-3.20</u>
			(fully achieved from year 4 onwards)					
			Net Revenue Funding Shortfall or Surplus (-)	0.19	5.35	-0.14	-2.03	-3.20
			Net Capital Funding Shortfall or Surplus (-)	0.00	0.00	1.85	0.00	0.00
			3.00 Request for addition Capital Grant			1.85		
			4.39 Revenue Resources released by Borrowing	0.19	4.20			
			Revenue Resources Released by use of Grant		1.15			