

Cumbria Police Authority

**15 February 2012
Agenda Item No 14(i)**

LOCAL GOVERNMENT ACT 2003 REQUIREMENTS REPORT

1 Introduction

The Local Government Act 2003 requires the Chief Financial Officer to report formally on the robustness of the budget for consideration immediately prior to setting the Budget and Council Tax. The report aims to ensure that the Authority is aware of the opinion of the Chief Financial Officer regarding the robustness of the budget as proposed, including the longer term revenue and capital plans, the affordability of the capital programme when determining prudential indicators and the adequacy of general balances and reserves. The Authority is required to take account of this report when determining its budget.

2 Robustness of the Estimates, Medium Term Plans and Tax Setting Calculations

Preparation for the budget, including decisions on key budget assumptions, takes place between November and February, with the budget being set 14 months ahead of the end of financial year to which it relates. Whilst the final recommended budget will always take account of the latest forecasts, the nature of the budget cycle means that there will always be some level of variation between the budget and actual expenditure. This risk is managed by ensuring that the budget process and estimates are robust and that balances and reserves are set at a level that takes account of financial and operational uncertainty. In giving a positive opinion on the robustness of the estimates and tax setting calculations reliance is placed on the Authority's overall arrangements for financial management.

All estimates are prepared in accordance with guidance issued by the Head of Finance following agreement by the Director of Finance and Resources. Estimates are prepared under the supervision and with the support of budget and accounting officers. These officers are under the professional supervision of the Head of Financial Services. Estimates are subject to scrutiny by Finance Services staff and the Chief Officer Group prior to being submitted to the Authority. In addition to detailed estimates for the immediate financial year, the Constabulary has developed and keeps regularly under review a Medium Term Financial Forecast (MTFF) covering four financial years. Key financial risks are identified within the Authority's strategic risk register and are subject to review based on the likelihood and severity of the risk. The processes for financial management are supported by scrutiny and challenge from the Finance and Policing Plan Working Group and Governance Committee. Account is also taken of the assessment of the Audit Commission as part of the annual audit opinion and the work undertaken by internal audit to assess governance arrangements and controls in respect of key financial systems and processes. I can confirm that in my view the Authority has robust procedures in place for determining estimates, medium term plans and the Council Tax requirements.

3 Determination of the level of resources available

The resources available to the Authority to support expenditure primarily derive from national formula and specific grants and Council Tax. The 2012/13 budget is based on actual settlement figures. Council Tax income forecasts have a historically high degree of accuracy in terms of tax base and collection forecasts. As such, a high degree of assurance can be provided in respect of the level of certainty for 2012/13 revenue resources. This level of assurance cannot be given to resources beyond 2012/13. There are a number of risks and issues that currently make the calculation of revenue funding forecasts challenging. Each of the key issues and the approach taken to managing the associated financial risk is set out below. The uncertainty in respect of these areas makes it difficult to provide a high degree of assurance. It is however my opinion that the approach taken, alongside the Authority's position with respect to reserves and balances, is both prudent and robust in view of the level of risk.

Council Tax Increase Principles

The 2012/13 budget is presented on the basis of three options for Council Tax increases and takes account of the Council Tax Increase Principles. The principles are set by Government each year and inform the percentage increase in Council Tax income allowed before the Authority would need to hold a public referendum. For 2012/13 the increase principle has been set at 4%. The medium term financial forecast is based on an assumption of a 3.6% annual increase in Council Tax to 2015/16. There is a risk to the budget that an increase of 3.6% will be above the level Council Tax Increase Principles set by the Government from 2013/14. Should this risk materialise Council Tax would need to be set at a lower level, income would reduce and the level of savings requirements in future years will increase. The financial implication will be dependent on the extent to which the current assumption is above the Government's increase principles.

National Funding Settlements

The budget for 2012/13 is presented based on notifications of the actual financial settlements. From 2013/14 the budget is based on indicative settlement information. In addition Government is undertaking a review of funding that is likely to change the basis on which funding is allocated to individual authorities and may change the balance of funding between Government Departments. This in turn will influence the total amount of funding available to be allocated locally. Some changes to formula funding are expected from 2013/14 with a more fundamental change from 2015/16.

The budget risk from the national settlement is therefore based on the high degree of uncertainty around the amount of future year grant allocations. The review of how funding is allocated carries a higher degree of risk for Cumbria due to our reliance on dampening (£14.5m). The budget estimates provide for an additional reduction in formula grant income of 1% in each of 2013/14 and 2014/15 specifically for the dampening risk.

There is a risk that these assumptions are insufficiently prudent and that actual formula grant allocations are reduced by a much greater amount. The budget is based on what are considered to be reasonable judgements about the likely level of funding reduction. It is however important to consider that the comprehensive spending review in 2010 announced a level of funding cuts that were significantly more extensive than most forecasts had assumed. In addition the front loaded nature of the reductions was generally unforeseen. There is therefore potential for future year national settlements to present further

significant budget pressures above the level of the existing assumptions. Should this risk materialise balances could be used in the short term to mitigate the immediate financial pressures. The level of uncertainty, potential for large funding variations and the significance of this area of income to the budget provide a sound justification for balances set at 5% of the net budget.

Specific Grants Moving into Formula Grant

In 2012/13 funding for Police Community Support Officers (PCSO) provided through a specific grant will be mainstreamed within Formula Grant. This has implications for the way the funding is distributed between authorities. Representations have been made through the Police Authority Treasurers Society that this change should not result in any Authority receiving less funding. There is no certainty with regard to the impact of distributing this funding through formula grant. Historically the mainstreaming of specific grants has been used as a means of reducing funding. PCSO funding has a value of £2.3m to Cumbria in 2012/13. The Authority also receives a Council Tax freeze grant of £858k from DCLG. This is currently allocated within the formula grant but as a separately identified amount. In the longer term both areas of funding, with a total budget implication of £3.2m, will be allocated on a different basis to the current local distributions. The budget does not currently provide any further level of protection for this risk other than the 1% assumption on funding losses above the indicative national allocations.

National Pay Freeze

National funding amounts are to be reduced to take account of the 1% national pay freeze announced in the Chancellor's Autumn Statement. There is currently no information on the amount of the reduction or the assumptions the Government will make about the level of pay inflation provided for within Local Authority budgets. In the absence of any definitive information, the Police Authority budget assumes a reduction in formula funding allocations equivalent to a 1.5% increase in the Authority's pay costs year on year for 2013/14 (736k) and 2014/15 (2025k). This is on an assumption that the government will estimate that pay provision has been budgeted at the level of 2.5% and that the full 1.5% will be taken from the government grant allocations.

Funding Allocations 2015/16 and Beyond

The Chancellor's Autumn Statement announced new Expenditure Totals for the end of the spending review period: 2015/16 and 2016/17. Over this period Total Managed Expenditure is set to fall by 0.9% in real terms. This means that the period of funding constraint is likely to continue beyond the existing CSR period. There is no information about how the reduction in expenditure will be allocated across different departments. Assuming an even allocation across departments and a 2% inflationary increase in funding, a real term reduction of 0.9% would limit grant increases to 1.1%. The budget currently assumes a 0.5% reduction in national funding for 2015/16 providing a cushion of 1.6% to cushion against formula changes and the risk of withdrawal of dampening.

Council Tax Localisation

From 2013/14 national support for Council Tax benefits will be localised. Each billing authority is responsible for designing a local scheme. National funding to support the cost

of Council Tax discounts will reduce by 10%. Localisation presents a number of risks to the Police Authority budget. The Government has yet to determine how to allocate the national funding but it will be a formula based allocation and therefore will differ to amounts actually received in 2012/13. The Authority will receive some of this funding instead of Council Tax but the amount could be more or less than actual tax income. Where local schemes reduce Council Tax discounts there may be an impact in collection rates resulting in a deficit on collection funds. Where local schemes retain all existing discounts the Tax Base will reduce by a greater extent than the level of national grant. Grants will be allocated at the start of the financial year with Authorities meeting the pressure of any in year increase in discount eligibility.

The exact extent of any financial pressures will only be capable of being calculated once districts develop their local schemes and information is provided on the national funding distribution. The potential budget pressure is estimated at £400k. This is based on a pro-rata share with Districts and the County of a 10% reduction in national funding to meet the cost of discounts. In practice it is likely that a proportion of this funding loss will be passed on to residents through local schemes that reduce the current level of discounts. The budget does not therefore currently provide for this risk other than through existing provision within balances.

Capital Grants and Capital Receipts

The capital budget has been developed as a 10 year programme. Government capital allocations are only given on an annual basis and the resources from 2012/13 have therefore been prudently based. Projects within the programme reliant on capital receipts have a 20% contingency provision below market value estimates to take account of the economic climate. Capital reserves are forecast to be available until 2016/17 providing a high degree of resilience in respect of available funding over the life of the medium term financial forecast.

Revenue and Capital budget plans are subject to annual review to ensure that forecasts of resources remain robust and can support planned levels of expenditure.

4 Affordability of Spending Plans

Whilst the process for developing budget estimates is robust there will always be a degree of risk and operational uncertainty in respect of expenditure forecasts. The affordability of the budget has to take account of financial risks and the actions that can be taken to mitigate that risk. There are a number of risks in the 2012/13 budget and medium term forecasts of expenditure. In my view the Authority's expenditure plans are affordable, taking account of the risks set out below and the plans for how they will be managed. Significantly, in the short term there is a risk of material under spend on the budget. The budget report recommends to the Authority that further consideration is given to this risk early in the new financial year once more accurate financial estimates are capable of calculation against a number of the issues set out below.

Capital Expenditure

The capital programme incorporates a £7m capital scheme developing a new Police Station for Barrow. The funding envelope for this scheme will be challenging and there will be financial and reputational risks inherent in delivering to time and budget. There are some risks around the delivery of capital receipts on which the scheme is reliant. The nature of the scheme and financial environment is likely to make any cost over-run high profile. Much of this risk can be managed though effective procurement and contract management processes. In addition the Authority has already demonstrated its capability through the Durranshill scheme to deliver this type of development. A financial contingency has been provided that covers 20% of the capital receipt funding for the scheme. Members should however be aware that this is an area of budget risk. The risk is contained within the estates risk register and will be subject to quarterly review.

The capital programme to 2015/16 includes over £6m in ICT capital schemes. The experience in 2011/12 is that £3.9M of ICT capital schemes have experienced slippage against the budget. The reasons for the slippage is varied and includes national schemes that have not progressed, local schemes that have been subject to changes in decision making and issues around capacity to deliver within the team. The level of slippage in the programme has been raised by the Audit Commission and in part contributes to a high level of capital reserves. The budget has re-profiled ICT schemes based on the best available information regarding their delivery. Past experience suggests that this may be a high area of budget risk regarding delivery. Whilst slippage in capital schemes does not create a financial pressure the consequent level of reserves can be subject to challenge in the context of budget cuts. There are also reputational implications for the quality of financial forecasting and management. To protect against these risks it will be important to understand the risks and issues inherent in the ICT programme and ensure that delivery is effectively supported.

The capital programme is currently sustainable on the basis of general capital reserves. Over £2m of general reserves underpin recurrent capital expenditure over the life of the medium term forecast. In addition significant capital schemes such as Barrow are reliant on one off revenue contributions and capital receipts. In the medium to longer term recurrent capital expenditure is exceeding the very limited sources of funding to support it. These are primarily a capital grant of £0.9m and a revenue contribution of £1.2m. There is currently no provision in the medium term for any significant re-investment in capital estate assets. Beyond 2016/17 the unfunded nature of the capital programme will present an annual revenue pressure of up to £2m. The financial risks presented by the capital programme are substantially longer term but will need fundamental review in the short to medium term to provide assurance that the value delivered from existing investment plans is commensurate to the revenue savings implications. Any fundamental changes around the programme may have contractual implications and significant lead in times to deliver change.

Treasury Management

Treasury management has the potential to be an area of high budget risk that could have implications for the robustness of the budget should those risks materialise. The Treasury Management papers elsewhere on the agenda provide assurances around the approach to investment and borrowing activity and the way the function is managed that mitigates against this risk. The Authority should however be aware that the level of risk against any investment activity is higher in the current financial climate than would typically be the case.

Capital Financing

The capital programme is financed through direct revenue contributions, capital grants, reserves and notional borrowing. Notional borrowing reflects an underlying need to borrow to finance capital schemes but where actual borrowing has not been undertaken because internal cash flow balances are sufficient to fund schemes. Many of the internal balances are available as a result of the level of short term reserves. As reserves are spent there becomes a need to actually borrow. The exact timing will depend on the extent to which capital schemes deliver to budget or are subject to slippage and the overall position on reserves. Borrowing will create a revenue implication in the form of interest charges that are not currently provided for within the budget. Any borrowing is undertaken against long term assets and typically for medium term to longer term durations to protect against interest rate and re-financing risks. This typically creates a financing cost of around 5%. The Authority is funding around £15m capital expenditure from internal balances that at 5% would create an annual budget pressure of £750k. The report on reserves provided elsewhere on the agenda estimates that these will be sufficient to maintain notional borrowing over the life of the MTF. The position will be kept under review with costs built into the revenue budget at the point in which they are forecast to materialise.

Inflation/Pay Awards

Pay costs are provided for within the budget on the basis of a 0% pay increase in 2012/13, 1% in 2014/15 and 2015/16 followed by 2.5% in 2016/17. Pay costs account for around 70% of the budget and are therefore highly sensitive to variations against the budget assumption. Whilst pay constraints have been announced nationally these will still be the subject of trade union negotiation with a risk of concessions. There may be pressure in 2015/16 for pay awards above 2.5% to compensate for the extended period of real term pay cuts.

Staffing Costs and Profiling

Within the budget employment pay and employment costs account for £85m of the £120m total expenditure. This area of budget is highly sensitive to changes in the profile of staffing and difficult to forecast as a result of the complexities of existing terms and conditions that influence actual pay. Maintaining officer numbers at a planned level can be operationally difficult as a result of the timing of staff turnover and lead in time to recruit. Estimates of the costs of early retirement (ER) and redundancy have to be based on averages until the point in which individual staff are identified as part of the change management programme. These factors can cumulatively given rise to significant variations between budgeted costs for pay and ER/redundancy. Historically there has been under spending against these budget heads. Under spend against a budget that incorporates significant savings requirements presents a risk that services have been reduced at a greater level or faster than is needed.

Windsor

The budget is currently presented ahead of any cost reductions that may be achieved from the implementation of the Windsor review. The current expectation is that the impact for Cumbria will present a budget saving. This position will however need to be reviewed in the context of the recent Police Arbitration Tribunal decisions and in particular the changed outcome on incremental progression. Whilst in the longer term the implications for the

budget are positive, early achievement of any savings is likely to create an under spend in 2012/13 against a position of budget surplus.

Savings Requirements and Budget Gap

The savings requirements for the 2012/13 budget are expected to have been delivered before the start of the new financial year and therefore present very little risk to the budget. The medium term financial forecast has however a budget gap of over £6m to 2015/16 after the achievement of further planned savings. There is a medium term budget risk in closing the financial gap given the level of savings that have already had to be made. The financial risk could to some degree be mitigated by staff turnover that can deliver a full year saving of over £3m across a 12 month period. This measure, whilst providing budget assurance, is however unlikely to support the strategic objectives and priorities within the policing plan. It will therefore be critical to both financial and operational performance that the change programme continues to bring forward carefully considered proposals to balance the budget on a timely basis. In the short term the implementation of savings for the 2013/14 financial year will create a part year savings effect currently unbudgeted that will increase the level of 2012/13 surplus.

5 General Balances and Reserves

General balances are held as a contingency against risks not provided for in the Authority's financial plans or other reserves and provisions. The level of balances, reserves and provisions are assessed annually to ensure they are adequate and take account of known financial risks. This is not a precise science and local circumstances, the strength of financial reporting arrangements and the Authority's track record in financial management is also a key influence on the actual potential of any risk materialising.

This report sets out the key risks that have been taken into account in presenting the budget, including any provision made for that risk. Some risks are currently unfunded whilst others have a level of provision that may be less than the full requirement. General balances should be at an appropriate level to provide cover for those risks. The Authority has set balances at 5% of net expenditure. This is a higher level than historically has been provided for and takes account particularly of the risk around income from the national funding settlements and the level of savings required in the medium term. Both of these risks are significant in the medium term.

Further cover is provided through the position on specific reserves set out below. Whilst these are earmarked a number of the reserves, particularly those for capital, are not planned to be used for a number of years. They provide an additional level of resilience in the short term although any use of these balances for other purposes will need to be repaid.

A report elsewhere on the agenda provides a detailed justification for the level of earmarked reserve and the purpose and amount of each of individual reserves. These reserves are subject to annual review to ensure that they are appropriate for the purpose they were set up for and are at the level required. Total reserves are expected to reduce from £21.5m in March 2012 to £15.3m by March 2016. A significant proportion of this reduction will arise from the movement in capital reserves from £8.7m to £3.8m. By 2015/16 consideration will also have been given to the position on general balances with potential to reduce these by

£2m subject to the outcome of the national funding review. This would further reduce total balances and reserves to £13.3m.

The most significant single earmarked revenue reserve is the management of change (MOC) reserve (£1.85m). This has been established to meet the costs of implementing the change management programme. The most significant area of cost relates to early retirement and redundancy payments. The difficulty of forecasting in this area and wide range of cost profiles that result from very minor changes in assumption make this reserve particularly difficult to set with a high degree of accuracy. Further to this, savings proposals are still awaited to close the budget gap in the medium term. As a result of this monitoring for MOC will now be undertaken during the year as part of the cyclical budget monitoring process.

Based on the risk assessment, the Authority's general balances are sufficient to meet potential risks and earmarked reserves are set at an appropriate level for the purposes intended.

6 The affordability of the Capital Programme in determining Prudential Indicators

The Prudential Code requires the Chief Financial Officer to ensure that all matters required by the Code to be taken into account in determining the budget are reported to the Authority. The Treasury Management report provided elsewhere on this agenda provides assurances in respect of this requirement. In particular the report sets out the prudential indicators and limits calculated under the Code including those that support assurances in respect of the affordability of capital expenditure plans. The Code of practice gives no suggestions as to their appropriate level. These have to be set by the authority itself based on individual circumstances.

The conclusions from the strategy following the setting and calculation of indicators is that capital expenditure plans are resourced and levels of borrowing are prudent in relation to the Council's income and assets. The Strategy is subject to annual review by the Chartered Institute of Public Finance and Accountancy to provide further assurance that the principles of the code and best professional practice is being applied in relation to operational processes and procedures.

7 Conclusion

Based on the assessment included in this report I have concluded that the budgets as proposed and the associated systems and processes are sound and the level of general balances/reserves is adequate. This is subject to no amendments being made to the budget proposals which would impact on this assessment. It is my view that the estimates proposed and the tax setting calculations are robust and the provisional capital programme is affordable.

Stuart Edwards
Chief Executive

Ruth Hunter
Treasurer/Deputy Chief Executive

7 February 2012

Human Rights Implications

None identified

Race Equality / Diversity Implications

Budget savings proposals are supported by the Change Programme Equality Impact Assessment (EIA) that is subject to regular review and update. Individual proposals where appropriate are identified for a specific EIA review.

Risk Management Implications

There is a legal requirement to set a balanced budget. The Authority's strategic risk register recognises the importance of sound financial planning.

Financial Implications

The main financial impacts are described in the paper

Personnel Implications

As identified in the report

Contact points for additional information

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