Cumbria Office of the Police and Crime Commissioner

Item 13 (A)
Executive Board February 24th 2016

Local Government Act 2003 Requirements Report

Report of the Chief Finance Officer

1. Introduction

1.1 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 Commissioner 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 Commissioner is required to take account of this report when determining the budget.

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

2.1 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 Commissioner’s overall arrangements for financial management.

2.2 The process for preparing the estimates involves a budget proposal from the Constabulary. The proposal is supported by detailed financial estimates prepared in accordance with guidance issued by the Constabulary's Chief Finance Officer. Estimates are prepared under the professional supervision of the Deputy Chief Finance Officer and with the support of financial services officers. Estimates are subject to scrutiny by finance services staff and the Constabulary's Chief Officer Group prior to submission to the Commissioner's Chief Finance Officer for further review.

2.3 Working papers for review include a full reconciliation between the base budget for the previous financial year and the proposed budget for the new financial year for each section of the budget. This is accompanied by the detail of the management accounts. The working papers support an analytical review of the reasonableness of variations between financial years against budget assumptions. The overall budget consolidates the Constabulary's budget proposal with detailed estimates of the Commissioner's direct expenditure; budget's commissioned with other third parties and estimates of income. The most significant areas of income are in respect of government grant and council tax. The budget is calculated using actual information from the settlement and district notification of the tax base.

2.4 In addition to detailed estimates for the immediate financial year, a Medium Term Financial Forecast (MTFF) is prepared covering four financial years. Key financial risks identified within the forecast are included within the Commissioner's strategic risk register and are subject to review based on the likelihood and severity of the risk. This ensures that the medium term profile of income and expenditure is based on a sound review of risk and uncertainty that informs budget assumptions and the level of provisions and reserves.

2.5 Internal audit undertake cyclical reviews of the main financial systems and processes. Both internal and external audit provide an annual opinion on governance and internal controls. In addition, the external auditor undertakes a review of financial resilience as part of the value for money conclusion within the audit findings report. Collectively this work provides assurance with regard to the accuracy and reliability of the financial information used in the budget setting process.

2.6 On the basis of the overall arrangements for financial management, and audit of those arrangements, I can confirm that in my view the Commissioner has robust procedures in place for determining estimates, medium term plans and the Council Tax requirements.

3. Determination of the level of resources available

3.1 The resources available to the Commissioner to support expenditure primarily derive from Home Office Police Grant (£59.5m). The next most significant funding source is Council Tax (£36.1m). The balance of expenditure is funded from specific grants, reserves and fees and charges. The 2016/17 budget is based on actual government grant settlement figures and district notifications of the Council Tax base. As such, a high degree of assurance can be provided in respect of the level of certainty for 2016/17 in respect of funding. This level of assurance cannot be given to resources beyond 2016/17. Whilst Council Tax income forecasts are reasonably assured, there is a high degree of uncertainty with regard to government formula and specific grants funding in future years. This means that there are a number of risks and issues that currently make the calculation of revenue funding forecasts challenging beyond the 2016/17 financial year.

3.2 Each of the key issues with regard to the availability of resources, and the approach taken to managing the associated financial risk, is set out below. It is my opinion that the approach taken, alongside the Commissioner’s position with respect to reserves and balances, is both prudent and robust in view of the level of risk.

Police and Crime Panel Veto

3.3 The arrangements for budget setting provide the Police and Crime Panel with a veto over the level of precept increase. The panel may determine that the precept increase is too high or too low. In these cases, the Commissioner is required to either reduce or increase the precept. It is for the Commissioner to determine the extent to which the precept is revised, having taken into account the views of the panel. For the 2016/17 budget the panel determined not to exercise its powers of veto and the budget is presented on the basis of the precept proposal supported by the panel of 1.91%. The position of the panel in respect of future year precept increases will not be known until January of the relevant financial year, presenting a risk in respect of the precept increase assumptions in the medium term budget.

Legacy Council Tax Grants

3.4 Council tax discounts are available to support low income households with the cost of their council tax liabilities. They are administered locally on the basis of schemes developed by district councils. Because these benefits were previously administered nationally, and the impact of the change reduces the local tax base and council tax income, a national government grant compensates precept and billing authorities for the funding loss. Further compensation is provided for financial years where decisions have been taken to freeze the council tax precept. Collectively these grants are known as Legacy Council Tax Grants. The amount of grant for Cumbria is £4.85m from a national fund of £507.39m.

3.5 There is a level of uncertainty in respect of longer term methodologies for distributing this funding and the mechanism through which the total amount of grant funding will be determined nationally. In addition, the calculation of the total national funding and its distribution is based on a number of assumptions. Where local circumstances vary from these assumptions, there will be a financial implication.

3.6 The level of government grant is set at the time of the financial settlement. The main risk in respect of the level of national funding is therefore in respect of future years grant allocations and the extent to which this funding is impacted by overall reductions in government department expenditure allocations. It is also unclear whether the national review of police funding will result in this and other specific grants being rolled into formula grant. This would result in a complete change in the distribution methodology with potential impacts from the 2017/18 settlement. The Commissioner's current share of the national total funding for Legacy Council Tax Grants is 0.96%. Cumbria's proposed share of the total pot for formula funding is between 0.71% and 0.63% depending on which methodology is used. This means that a consolidation of the grant into the formula funding distribution, even assuming no reduction in the amount of funding at a national level, would result on a funding loss of between £1.2m and £1.6m for Cumbria.

3.7 A further risk is the potential for an increase in local claims for council tax discount. Experience of the last three years suggests that this risk is low as the move to local schemes has not resulted in any significant changes between former benefit and current discount applicants. It is however known that there are gaps between the proportion of households eligible for discounts and the proportion that actually claim. Should this risk materialise there will be an implication for the collection fund managed by districts that will be shared with all precepting bodies. A high level estimate of the impact of this risk suggests that a 10% increase in claims would have a financial implication of around £400k for the Commissioner's budget.

Council Tax Base & Collection Fund Surplus and Deficits

3.8 The amount of council tax income is dependent on the level of council tax and the council tax base – the number of households in Cumbria, within property bands A to G, with a liability to pay their council tax bill. The council tax base is known for 2016/17 but may go up or down compared to the forecasts for the three final years of the medium term financial forecast. The forecast assumes that from 2017/18 the annual increase in tax base is 0.75%. This presents a cumulative risk to the budget of £870k by 2019/20. Estimates have however been prepared based on a rolling average for the previous forecast period and are considered to be robust. They will be revisited on an annual basis.

3.9 In any single year the actual council tax income collected from households by district councils can be higher or lower than the amount forecast at the time of setting the budget. Any variation is shared with precepting authorities and will impact on the total amount of council tax income in future years. The factors influencing the council tax base and actual income collected are complex and difficult to forecast. There is therefore always a risk that income does not meet budgeted amounts. This is however considered to be a small risk as more recent trends, following council tax localisation, has been for actual income to exceed the forecast. The budget currently assumes the surplus will be £200k per annum from 2017/18.

Council Tax/Council Tax Grant Risk

3.10 Collectively, the factors above mean that the ability to accurately forecast council tax income and the local council tax grant, in the medium term, is becoming complex, reducing the amount of assurance that can be provided from income forecasts beyond 2016/17. However a high degree of assurance can be provided with regard to the combined income from council tax and council tax grants for 2016/17. Whilst future income will be less certain, the most significant risks are in respect of formula funding. Variations to risks outside the funding formula are likely to be capable of being managed without having a material impact on the robustness of the budget or financial resilience.

National Funding Settlements

3.11 The budget for 2016/17 is presented based on notifications of the actual financial settlements. Beyond 2016/17 financial forecasts are based on estimates. The current medium term forecast assumes a flat rate of Government funding for the next four years, based on the total police grant for 2016/17, but applies an estimated reduction of £9.9m due to formula funding changes. The full range of potential formula funding impacts has been estimated to be between £9.9m and £15.8m for core Police Grant. Whilst the budget does not take account of this level of financial risk in full, the Change Programme that is tasked with delivering financial savings is developing options for cost reduction to cover the full range of estimated formula funding reductions. Application to the Home Office will need to be made for transition funding to support the budget pending the implementation of the Change Programme.

3.12 This strategy carries some level of risk, making the assumption that any changes to formula funding will be supported by sufficient transitional funding to allow time to implement material changes in operational services. It is however considered to be a balanced approach given the high level of uncertainty regarding the timing and impact of changes to national funding formula.

Capital Grants and Capital Receipts

3.17 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 2016/17 have therefore been prudently based. Overall funding within the programme is reliant on capital receipts and this presents some risk to funding given the economic climate and market conditions. Capital reserves are however managed at a level to ensure that the programme is balanced for four years. This provides a high degree of resilience in respect of available funding over the life of the medium term financial forecast.

4. The affordability of Spending Plans

4.1 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. Whilst the process for developing budget estimates is comprehensive, 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. In my view the Commissioner's expenditure plans are affordable, taking account of the risks set out below and the plans for how they will be managed.

Capital Expenditure

4.2 The capital programme incorporates the delivery of two significant estates capital schemes. These comprise a Estates North Resilience/Flood Management scheme at the Penrith HQ site including the delivery of a Strategic Co-ordination Centre, planned for delivery by 2018/19 and a longer term scheme Estates West scheme to manage estates resilience issues within the west of the county. Both schemes are reliant on achieving capital receipts from the disposal of vacated sites. Within the current market this will entail some risk that income is either delayed or less than the amount assumed the within the budget. The North Resilience Scheme funding is dependent only on small levels of capital receipt income but the funding envelope for this scheme will be challenging and there will be financial and reputational risks inherent in delivering to time and budget. These may be more challenging as key stages of the project will require partnership sign off. The risks to this project will be maintained within the estates risk register and will be subject to regular review.

4.3 The capital programme 2016/17 and 2017/18 includes £9m in ICT capital schemes. The experience of past financial years is that ICT capital schemes can experience 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. 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.

4.4 The capital programme is currently only sustainable on the basis of general capital reserves. In addition, any significant level of capital investment is reliant on one off revenue contributions and capital receipts. The programme is however forecast over 10 years to ensure advanced financial planning can be managed and peaks in expenditure are identified at an early stage. The revenue budget implications of the programme have been built into the medium term forecast.

Treasury Management

4.5 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 strategy statement provides assurance around the approach to investment and borrowing activity and the way the function is managed that mitigates against this risk. The Commissioner 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

4.6 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 will become a need to actually borrow.

4.7 The exact timing of borrowing 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. These charges are provided for on a recurrent basis from 2019/20. Should the requirement to borrow arise earlier than this date, this will create a budget pressure. This is however a low risk given that the significant reserves are held pending the delivery of capital schemes that will operate to a known and managed project plan.

Inflation/Pay Awards

4.8 Pay costs are provided for within the budget on the basis of a 1% pay increase for the duration of the medium term forecast. Pay costs account for the most significant element of the budget and are therefore highly sensitive to variations against the budget assumption. This risk is however mitigated as a result of public sector pay constraints announced nationally. Whilst pay is still be the subject of trade union negotiation with potential for concessions, this is not considered to be a material risk to the budget.

Staffing Costs and Profiling

4.9 Within the budget employment costs are an area of budget that is highly sensitive to changes in the profile of staffing and difficult to forecast as a result of the complexities of and changes to 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 give 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.

Savings Requirements and Budget Gap

4.10 The overall savings requirement over 4 years to balance the budget is £11.6m. The change programme savings for the 2016/17 budget are £2.5m and have been subject to planning and decision making with the required budget reductions being fully incorporated within the proposed budgets. They therefore present a low risk to the budget although there will be some risk that implementation does not achieve the level of savings in the plan. The net position, assuming the delivery of 2016/17 savings is a requirement for over £9m of further reductions. From 2017/18 savings have been planned but in some areas those plans are at a high level and subject to further detailed work and decisions. There are £4m of savings requirements by 2019/20 for which plans have still to be developed. This means that there is a higher risk of delivery in respect of the savings programme in later years of the medium term forecast. A key mitigating factor to this risk is that the Constabulary has a good track record of delivering savings. In addition the revenue and capital budgets provide for a significant amount of investment in ICT mobile and digital working to facilitate the necessary reductions in staff numbers.

4.11 Any underachievement in the level of required savings presents a risk of budget deficit. Should this materialise, the risk could to some degree be mitigated by a freeze on recruitment. In an average year, staff/officer turnover typically delivers a full year saving of between £2m and £3m across a 12 month period. This measure, whilst providing budget assurance, is however unlikely to support the strategic objectives and priorities within the police and crime plan. It will therefore be critical to both financial and operational performance that the change programme continues to bring forward and implement carefully considered proposals to balance the budget on a timely basis.

5 General Balances and Reserves

5.1 General balances are held as a contingency against risks not provided for in the Commissioner’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 Constabulary’s track record in financial management is also a key influence on the actual potential of any risk materialising.

5.2 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 Commissioner’s Chief Finance Officer has set balances at £3m for 2016/17. This is around 3% of net expenditure and reasonable in the context of the budget risks set out in this report. These general balances are supported by £1m of operational reserves and contingencies. These can be used to manage budget pressures in year that are unable to be contained within the set budget, being replenished as part of the following year’s budget process.

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

5.4 Based on the risk assessment, the Commissioner’s general balances are sufficient to meet potential risks and earmarked reserves are set at an appropriate level for the purposes intended. More information on reserves and the purpose for which they are held is included within the Commissioner’s policy on reserves, appended to the revenue budget report on this agenda.

6 The Affordability of the Capital Programme in determining Prudential Indicators

6.1 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 Commissioner. The treasury management strategy statement provides assurance in respect of this requirement. In particular the strategy 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 Commissioner based on individual circumstances.

6.2 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 income and assets. The strategy is subject to review by the Joint Audit and Standards Committee and independent advisors 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

7.1 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.

Ruth Hunter

Chief Finance Officer/Deputy Chief Executive

24th February 2016