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**Report of the Chief Executive
To the Chair and Members
Of the Police Authority Executive
25th February 2010**

**Executive and Presenting Officer: Joe McCarthy
Status: For Noting**

**ROBUSTNESS OF ESTIMATES AND ADEQUACY OF FINANCIAL
RESERVES**

1. Purpose of the Report

1.1 This report is written in accordance with the requirements under Part 2 of the Local Government Act 2003 (Financial Administration). This requires the Treasurer (i.e. in our case the Chief Executive) to report to the Authority on the following matters:-

a) 'the robustness of the estimates made for the purposes of the calculations in setting the budget for the forthcoming financial year';
and

b) 'the adequacy of the proposed financial reserves'.

2. Recommendations

Members are;

2.1 Requested to consider the contents of this report, particularly section 6, and take them into account when considering the 2010/11 Budget Report.

3. Background

3.1 As Members will recall there is a requirement for the Treasurer to report formally and specifically on the robustness of estimates and the adequacy of the level of reserves contained within any budget proposals being considered by the Authority. Members will also be aware that the budget setting process

commences formally in September through to the final date of Authority approval in February of any given financial year.

- 3.2 In order for the process to be conducted in an accurate and robust manner, there are a number of key principles and activities that must be in place to provide confidence that the estimates produced are reliable and reasonable. These are detailed in sections 4 and 5 below.

4. Robustness of Estimates

4.1 Financial Strategy

4.1.1 The Authority has established a framework, whereby the four year Long Term Financial Plan (LTFP) regime seeks to provide stability and confidence in supporting the achievement of the Authority's and Chief Constable's priorities and objectives. These are set out in the CPA Business Plan (2010-2013) and the Policing Plan (2010-2013). The LTFP looks in detail at the forthcoming year and projects forward over the following four years. The forthcoming year is the last year of the present Comprehensive Spending Review (CSR) round. A CSR for following years will not be announced before the Election leading to considerable doubt about the levels of Formula Funding.

4.1.2 At its meeting on the 26th January 2010 the Police Authority considered a report about the potential implications for Formula Funding in 2011/2012 through to 2014/15. Notwithstanding the wish to maintain front line resources it is clear that the public sector faces significant reductions in resources as part of plans to cut the budget deficit. Our strategic response, which will be aided by the implementation of Project I, is to explore service options assuming respectively, 3% and 5% year on year reductions in Government Funding. This work will be the subject of further reports to Members, as part of the process to further develop the financial strategy which provides options maximises service levels within the available resources.

4.1.3 Turning to the budget for next year, as previously reported the Authority has received the minimum increase in Formula Funding of 2.5% and consequentially to maintain services at the current level an increase in the precept of 4.6% would be needed. However the Authority is mindful of the effects of the recession on the communities in the Force area and has required the Force to identify further savings in order to limit the increase in Precept to 2.94%.

4.2 Key Processes to Ensure Robustness of Estimates

4.2.1 With my role as Treasurer I aim to ensure that processes, systems and mechanisms are in place to deliver a budget, which is sound and robust. The production of estimates and the closure of accounts are two of the most fundamental activities for which the Treasurer is responsible.

4.2.2 Responsibility for the day to day management of the financial activities of the Force is delegated by the Chief Constable to the Force's Assistant Chief Officer (Finance and Commissioning). It is the ACO (F&C)'s responsibility to ensure that Force systems and procedures are in place to prepare the budget estimates, in accordance with the requirements of the Treasurer. To support this process Authority Financial Regulations and Force Financial Instructions are in place.

4.2.3 The main components of the budget estimate process are listed below and demonstrate the reliability of the estimates produced;

- A budget timetable is agreed by the Chief Executive and the ACO (F&C) and is adhered to by all concerned in the production of estimates.
- The ACO (F&C) leads on the co-ordination of the budget systems and procedures.
- Professional Codes of Practice, the Authority's Financial Regulations and Force's Financial Instructions are adhered to by Force Finance and Administrative Officers underpinned by appropriate qualifications and experience, including the principles of probity and stewardship, which are founded on sound ethical and cultural values.
- Force Finance and Asset Managers and/or Accountancy staff prepare estimates, which can be substantiated by supporting information.
- Service Unit Managers (SUMs) are fully involved in the budget process.
- All budget proposals underpinning service activities include full expenditure and income implications.
- Differentials are made between revenue and capital expenditure and the appropriate sources of funding, including the revenue implications of capital expenditure.
- All known existing and future pressures are identified and proposed strategies and solutions proffered to remedy any problems.
- All savings targets are clearly identified
- Any issues of under / overspending are addressed as part of the budget process.
- Risks associated with expenditure and income are identified.
- The ACO (F&C) liaises with the Chief Executive, to co-ordinate a joint budget monitoring report.
- Consultation with Members and other stakeholders takes place during the development of budget proposals.

4.2.4 The setting of the budget is not an isolated activity in itself, as there is regular reporting on budget monitoring throughout the financial year. Through frequent monitoring and reporting on performance against budget to the Authority's panels, the Chief Executive and the Chief Constable ensure that the financial pressures and issues facing the Authority and the Force are highlighted as soon as possible to allow management action to address any challenges that may arise.

4.3 Uncertainty & Risk

4.3.1 Despite having a robust and systematic approach towards setting the budget, there will always be areas of uncertainty. Assumptions have to be made on a number of issues such as the level of inflation for the forthcoming year. All such calculations are based on the best available information at the relevant point in time. Other component elements of uncertainty are listed below as examples:-

- The impact of the current economic recession.
- Police Officer and Police Support Staff Pay Award
- Final level of Specific Government Grants
- Sudden impact of activity against volatile budgets, e.g. major incidents.
- A future Comprehensive Spending Review and its impact on the LTFP.
- Partnership funding.

4.3.2 The budget process acknowledges and addresses such uncertainties by ensuring that estimates are based on the latest available information and undertaking research which combines historical trends with the likelihood of future outcomes. As mentioned in 4.2.4 above, the importance of budget monitoring is critical as an ongoing process to ensure that all external and environmental variables impacting on the Authority are recognised and their implications dealt with in a strategic manner as and when new information is made available.

4.3.3 The Authority and the Force have implementing revised arrangements for risk management and these all play an important part in identifying risk areas, of which financial risk is one, and the appropriate actions to be taken to minimise those risks. This work is being further refined as progress is now being achieved on developing business continuity arrangements, though this is still in its early stages.

4.3.4 The Authority's estimates include contingencies for probable costs that are likely to be incurred by the Authority over the course of the financial year. This coupled with adequate reserves, provisions and balances provides the Authority with the financial flexibility to deal with uncertain and unforeseen expenditure pressures.

5. Adequacy of Financial Provisions, Reserves and Balances

5.1 The adequacy of financial reserves is the second requirement on which the Treasurer must have confidence. In reality, there is no real difference between the factors that determine both the level of reserves and the estimates themselves. Reserves are simply longer term planning mechanisms to set aside resources for a future use. As such, the section above dealing with robustness of estimates can be fully applied to arriving at a confident statement that reserves are adequate in nature i.e. the Financial Strategy and processes and procedures within the overall budget strategy all culminate in

determining the level of reserves required to support the Long Term Financial Plan.

5.2 Reserves & Provisions

The Authority maintains a number of reserves and provisions, the largest and most significant of which are the General Fund, an earmarked reserve for Direct Revenue Funding of Capital, and the Insurance Fund.

5.2.1 General Fund

At 31st March 2009, the General Fund stood at £6.285 million, 5.0% of net budget requirement. The original budget for 2009/2010 provided for a contribution to support expenditure of £1.4million (and a further £0.5M from the air support unit reserve). As at the budgetary control report to the end of December the contribution required to balance the budget is likely to be £0.925million giving projected year end balances of £5.360million at the end of March 2010, as set out in the following table.

General Reserves			
	General Reserves	Net Budget Requirement	Reserves as a %age of NBR
	£k	£k	%
Forecast Balance as at 31.03.09	6,285	124,623	5.0%
Budgeted Transfers to Revenue in 09-10	-1,400		
Transfer Air Support Contribution	-500		
Reduced support from General Fund	975		
Forecast Balance as at 31.03.10	5,360	128,790	4.2%
Transfer Air Support Contribution	-250		
Budgeted Transfers to Revenue in 10-11	-675		
Forecast Balance as at 31.03.11	4,435	132,172	3.4%
Budgeted Transfers to Revenue in 11-12	-300		
Forecast Balance as at 31.03.12	4,135	129,172	3.2%

It is proposed to utilise £0.925 million of reserves to support expenditure in 2010/2011. This includes £0.250 million funding for the helicopter. After 2010/2011 the use of general fund contributions to support the budget will be limited and will be dependent on decisions made about future levels of government funding. In the plan period the reserves meet the policy to maintain prudent reserves [Appendix A].

5.2.2 Direct Revenue Funding of Capital

This reserve is held to meet the cost of capital schemes in future years, and amounted to £2.549 million at the start of 2009/2010. The predicted outflows to pay for capital expenditure in year suggest that this reserve will amount to £2million by 31st March 2010.

Members will recall that the planned adoption of International Financial Reporting standards, that required the Authority to make a charge for Time Off in Lieu and accrued holidays, has been delayed and it now expected to impact in 2010/11. However should the Authority be required to account for TOIL, it is still not clear whether the accounting treatment would impact adversely on reserves.

The current strategy to manage this change is to return the £2m mentioned above, from the Earmarked Reserve, to the General Fund. When the charge for TOIL and accrued holidays is made for the first time in 2010/11 this additional £2m of funds will ensure that general reserves are maintained at a prudent level. The Authority remains committed to reducing the impact of TOIL from both a financial perspective and "Work-Life Balance" policy.

5.2.3 Insurance Fund

The Authority maintains an Insurance Fund that covers virtually all insurable risks with a limited amount of external cover for special risk incidents and to cover accumulated losses exceeding an agreed amount depending on risk. The amount at the beginning of 2009/2010 amounted to £1.560 million.

Based on an independent actuarial review of the insurance fund, as at 31st March 2008, it was estimated that £1.32m of claims payments will have been made from the Fund after the 31st March 2008 relating to incidents that occurred between 1/12/1995 and 31/03/2008. They also suggested that based on the funds claims experience it would not be unreasonable to have a surplus of £0.5m. This figure is subject to change as settlements are agreed. At 31st March 2009, the Insurance Fund balance was £1.56 million (a surplus of £0.24m).

6. Treasurer's Statement

6.1 As Treasurer it is my duty to specifically comment on the robustness of the estimates put forward for the Authority's consideration. For the reasons set out in this report and from my own review of the estimates process I am satisfied that the proposed spending plan for 2010/11 is sound and robust. To address the projected funding pressures (in 2011/12 and beyond) and any the additional spending pressures raised, at a precept level which acknowledges national and local aspirations, will require a combination of structural changes in service delivery and significant recurrent savings to be achieved over the plan period.

6.2 It is clear that from 2011/12 onwards the Authority will potentially be subject to the most stringent financial climate – this will require the delivery of savings and efficiencies to balance the budget year on year. The Long Term Financial Plan 2010/11 to 2014/15 outlines the Authority's strategy to address this issue. It is of paramount importance that the strategy is clearly articulated, developed, planned and ultimately delivered by the Authority and the Force.

- 6.3 A review has been undertaken of the Authority's reserves, provisions and General Balances. The Authority's General Balances and reserves are an important part of the Authority's risk management strategy giving the financial flexibility to deal with unforeseen costs or liabilities. Assuming the approval of the plan set out in the budget report, I am satisfied that the Authority would have adequate levels of financial reserves and General Balances through 2010/11 provided that service restructuring is delivered and future growth, if any, is managed and funded from sustainable savings.

7. Implications

Finance

- 7.1 Other than the references made above there are no specific financial or staffing implications in respect of this report.

Risk

- 7.2 There will always be an element of risk that estimates are not fully robust or accurate which may lead to unfunded budget pressures becoming apparent during the year. This report sets out the process and basis for ensuring robustness and minimising the risk of unforeseen problems. As outlined in the report the Authority should ensure that it sets aside sufficient balances to ensure that any problems and liabilities can be dealt with.

8. Conclusion

- 8.1 The Authority's budget setting process has been designed to ensure that estimates brought forward for approval are sound and robust. This report confirms that approach and identifies the key elements of the process that make it so.
- 8.2 Similarly, the Authority policy is to ensure that it has sufficient levels of reserves and balances to provide for known, anticipated and unforeseen costs and liabilities. I am satisfied that the proposals emerging from the 2010/2011 budget process are clear, soundly based and deliverable, and that the approach to reserves and balances contained therein are appropriate.
- 8.3 In setting a budget for 2010/2011 the Authority will need to continue to have regard to the underlying level of available resources. The budget report requires the Authority to continue to take a robust approach to this issue by agreeing a long term financial plan aimed at maintaining a sustainable position through the Plan period.

Joe McCarthy
Chief Executive

Accounts and Audit Regulations 2003 (as amended)
Files held in Force Corporate Finance, and Police Authority.

Cleveland Police Authority

Reserves Policy

1. Reserves will only be established in accordance with legislation or codes of practice, for defined purposes and only with the approval of the Police Authority. When reviewing the long term financial plan and preparing the annual budget, the authority shall consider the establishment and maintenance of reserves.
2. These can be held for three main purposes:
 - A working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing - this forms part of general reserves.
 - A contingency to cushion the impact of unexpected events or emergencies - this also forms part of general reserves.
 - A means of building up funds, often referred to as earmarked reserves, to meet known or predicted liabilities.
3. The Authority's general reserve will act as a safety net against the risks of:
 - a) reductions in damping grant,
 - b) in year reductions in budgeted partnership funding
 - c) and unforeseen circumstances such as:
 - Expenditure on major incidents that significantly exceed the budgeted provision for such incidents.
 - Levels of inflation that significantly exceed the budgeted provision.
 - Expenditure on "demand-led" lines that significantly exceed the budgeted provision.
4. The appropriate level of the general reserve will be assessed each year when the budget is set. The assessment will have regard to the circumstances and budget for that year, to prospects for future years' budgets, and to any Home Office policy on special grant. The minimum level of the general reserve shall be 3%.
5. The application of the general reserve will require the specific approval of the Authority's Policy and Resources Panel. In the normal course of events decisions will be made on the principle that a one-off contribution from the general reserve should be made to support one-off and not continuing expenditure.
6. The position on the general reserve will be monitored in-year by the Policy and Resources Panel as part of the budgetary control process, and proposals brought to deal with any significant adverse movements compared with the budgeted position. The presumption will be that any nett underspending on the revenue budget shall flow to the general reserve unless there is an in year decision to utilise this to address performance matters.