

**Decision No: 2018/24**

Report to: Police and Crime Commissioner for Lancashire
Report By: Steve Freeman, Chief Finance Officer
Date: 23 July 2018
Title: The Police and Crime Commissioner for Lancashire's Reserves Strategy 2018/19

Executive Summary

This report sets out a revised Reserve Strategy for 2018/19 for the PCC's approval. The revision reflects recently released guidance from the Home Office and the confirmed year end position on reserves.

The Home Office guidance requires certain presentational elements to be provided in all PCC reserve strategy documents and the revised strategy document meets these requirements.

Compliance with this guidance is a pre-requisite for PCCs to meet the actions set out by the Minister for Policing in his settlement statement to ensure grant funding for PCCs provided in 2019/20 is at the same level as that provided in 2018/19.

This strategy forms an integral part of the Commissioner's Medium Term Financial Planning process that enables the effective planning and control of the revenue budget and the capital investment programme.

Recommendations

The Police and Crime Commissioner is asked to approve the revised Reserves Strategy for 2018/19.



Decision taken by the Police and Crime Commissioner		
Original decision, as set out in the attached report, approved without amendment (please delete as appropriate)	YES	NO

Original decision required to be amended and decision as detailed below:

The reasons for the amended decision:

Police and Crime Commissioner - Comments:

Declarations of interest

The PCC is asked to consider any personal / prejudicial interests he may have to disclose in relation to the matter under consideration in accordance with the law, the Nolan Principles and the Code of Conduct.



STATEMENT OF COMPLIANCE

The recommendations are made further to legal advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation.

Signed:

Police and Crime Commissioner

Date: 24th July 2018

Signed:

Chief officer

Date: 24/7/18

Signed:

Chief Constable

Date:

Signed:

Chief Finance Officer

Date: 24/7/18

1. Introduction

- 1.1. This paper provides information on the estimated level of reserves currently held by the Commissioner and proposes a Reserves Strategy for approval by the Commissioner
- 1.2. The reserves strategy sets out the use of general reserves and earmarked reserves (which are set aside for a specific purpose) and forms part of the Medium Term Financial Strategy which is updated regularly and reviewed by the Commissioner and Chief Constable.
- 1.3. In preparing this report the legislative and other requirements for the holding of reserves has been reviewed. The current financial position in respect of both the revenue budget and the capital programme, assessments of current and future risk, reserve levels in other Forces and views expressed by government, peers and the public have also been considered.

2. Legislation and guidance regarding the holding of a general reserve

- 2.1. Legislation and CIPFA guidance (2014) require that a general reserve is maintained but do not stipulate the level of that general reserve. However, the guidance does require the PCC to consider strategic, operational and financial risk when determining reserve levels with advice from the Treasurer. In addition the Local Government Act 2003 requires the S151 officer (the PCCs Treasurer) to report on the level of reserves annually, the planned usage and the opportunity cost of holding those reserves.
- 2.2. CIPFA's Guidance Note on Local Authority Reserves and Balances(1) states that a general reserve is required to act as "a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves". A general reserve is also required to act as "a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves."
- 2.3. Maintaining a general reserve ensures compliance with the Local Government Finance Act 1992 (2) which states that authorities must "have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement."
- 2.4. As part of the annual audit of the Commissioner's Statement of Accounts the external auditors provide an opinion on the level of reserves held by the Commissioner thereby providing an external scrutiny of the level of reserves being held.

3. Factors to consider in deciding on reserve levels

3.1. Overall financial position and adequacy of financial control

- 3.1.1. In setting the level of the general reserve it is important to bear in mind Lancashire's overall financial position and the adequacy of financial control in operation.
- 3.1.2. The overall financial position has been considered by the PCC as part of the budget process and medium term financial planning, which has taken account of the impact of the government's austerity measures.
- 3.1.3. It is also important to remember the context of the medium term financial plan agreed as part of the budget process so that the PCC continues to comply with CIPFA's Guidance Note on Local Authority Reserves and Balances which suggests that "Advice should be given on the adequacy of reserves over the lifetime of the medium term financial plan".
- 3.1.4. The use of general reserves does afford the PCC some flexibility in managing the Medium Term Financial Strategy and the Capital Programme over a number of years where future investment is considered against the pressure placed upon the annual revenue budget.

3.2. Risk exposure and risk assessment

- 3.2.1. Reserve levels must be considered in the context of risk if we are to comply with CIPFA's guidelines which state that "in order to assess the adequacy of unallocated general reserves.....Chief Financial Officers should take account of the strategic, operational and financial risks facing the organisation."
- 3.2.2. Whilst risk exposure and mitigation of that risk may not necessarily drive a material increase in spending, it will influence the level of general reserves year by year.
- 3.2.3. The key risks currently relevant to the level of general reserves now and in the future are;
 - Future Funding Gap – the risk that due to the increase in Demand faced by the force and the real reduction in funding from government, the increased resource requirements will have a significant effect on already stretched financial resources. This pressure is likely to impact on operational policing which in turn has an impact on the achievement of targets in the PCCs Policing Plan.
 - Uncertain central funding after 2018/19 due to proposed changes to the police funding formula.
 - The ongoing use of "top slicing" that has increased every year since its introduction which in turn increases uncertainty over the level of funding individual forces will have in future years.

3.3. Public opinion

3.3.1. A key factor in determining a General Reserves Strategy continues to be public opinion. The public’s acceptance of the precept is partly reliant on the understanding that the precept is spent on policing and that only a reasonable and prudent amount of any over-funding is being stored away as a General Reserve. Conversely, when unforeseen expenditure arises, such as with the anti-Fracking protest in Lancashire, it is likely that the public would expect the organisation to have sufficient resources to cover the expense without recourse to overspend.

3.4. There have been a number of statements from Home Office ministers in recent weeks that have led to a belief that the level of reserves held by some PCCs can be used as a means to meet additional ongoing cost pressures. This is considered a risk as the PCC’s plans to employ reserves could be disrupted by any initiative from central government to rely on our reserves. It is also a flawed argument as it can only ever deliver over the short term and cannot provide a sustainable position.

4. General reserve levels and their use

4.1. Use of General Reserves

4.1.1. The current strategy for general reserves levels is a level between 3% and 5% of the annual revenue budget. This reflects the consideration of the factors set out above and has been confirmed as appropriate by the external auditors in their review of the Statement of Accounts for 2017/18.

4.1.2. The Commissioner's general reserves are available to support the medium term financial planning process and to provide a source of funding for investment in the capital programme if required.

4.1.3. The use of general reserves does not provide an on-going revenue funding stream to support the revenue account position. However, notwithstanding issues related to risk and medium term planning, it is reasonable to use reserves to fund initiatives in the short term that them-selves had on-going positive revenue funding implications. These initiatives are known as “invest to save” options.

4.2. In order to assess the adequacy of unallocated general reserves (otherwise known as general balances) when setting the budget the PCC, on the advice of the two chief finance officers, should take account of the strategic, operational and financial risks facing the authority. This assessment of risk should include external risks, such as flooding, as well as internal risks, for example the ability to deliver planned efficiency savings.

4.3. Table 1 examines how Lancashire currently complies with the 7 key CIPFA principles to assess the adequacy of reserves.

Table 1: Compliance with the 7 key principles

Budget assumptions	Current situation in Lancashire
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The treatment of inflation and interest rates	<p>The PCC and Chief Constable (CC) make full and appropriate provision for pay and price rises.</p> <p>An informed assessment is made of interest rate movements.</p> <p>All individual expenditure and income heads in the revenue budget are prepared and published at estimated outturn prices.</p>
Estimates of the level and timing of capital receipts	The PCC and CC make a prudent assumption of future capital receipts.
The treatment of demand led pressures	<p>The Force is required to operate and manage within its annual budget allocation.</p> <p>The PCC retains a central reserve to help finance large scale or corporate operations or issues, the 'Operational Policing Reserve'</p> <p>In addition the CC holds a delegated 'DFM reserve' to deal with day to day changes in demand and pressure.</p> <p>The Force has been able to accommodate the additional costs arising from the various major incidents over the last 10 years without asking the PCC for additional reserve funding. However in 2017/18 there is a significant pressure on the budget in respect of the policing of anti-fracking protests in Lancashire. If a special grant claim is unsuccessful the operational policing reserve is likely to be called upon to fund the operation.</p> <p>The Force has already identified £6.2m of cash savings which will be removed from the budget over the next four years (2018/19 to 2021/22). This means that £84.6m of cash savings have been removed from the base budget since 2011/12. A funding gap of £18m has been identified to 2021/22 which means that over £102m of savings will have been delivered by 2021/22.</p>

	<p>This cumulative level of budget reduction will inevitably mean that operational budgets will come under even greater pressure and/or risk of overspending in future years.</p> <p>Some government grants (e.g. DSP) are announced annually in advance and are cash limited. Any new policing pressures arising during the year will have to be funded from the PCC and Constabulary's own resources.</p> <p>The PCC and CC have created a number of earmarked revenue reserves to help finance specific, ad-hoc, expenditure commitments. Appropriations are made to and from these reserves on an annual basis, as required.</p> <p>Finally, general balances are used as a last resort to manage and fund demand-led spending pressures.</p>
<p>The treatment of planned efficiency savings/productivity gains</p>	<p>The Force has consistently achieved its annual savings target.</p> <p>As explained above, over £84m of cash savings has already been taken out of the base budget with a further £18m required over the next four years.</p>
<p>The financial risks inherent in any significant new funding partnerships, collaboration, major outsourcing arrangements or major capital developments</p>	<p>The financial consequences of partnership collaboration working, outsourcing arrangements or capital investment are reported to the PCC as part of the medium term planning process. Where relevant, any additional costs are incorporated in the annual revenue budget and/or capital programme.</p> <p>There is clearly a risk that local authority partners will continue to withdraw funding as their own budgets are squeezed, or that the continued financial viability of private sector commercial partners will be exposed to risk in the face of an economic recession.</p>

<p>The availability of reserves, government grants and other funds to deal with major contingencies and the adequacy of provisions</p>	<p>The PCC has created a number of earmarked revenue reserves and provisions to meet specific expenditure items. These are referred to in more detail in paragraph 5 below.</p>
<p>The general financial climate to which the authority is subject.</p>	<p>In November 2015 the Chancellor announced that police funding would be protected in real terms over the CSR period. At the same time he announced that he would maintain local police force budgets at current [2015] cash levels, assuming PCCs increased council tax by around 2% p.a.</p> <p>In the final police grant settlement announced on 31st January 2018 the Policing Minister announced that PCCs would be able to increase Band D council tax by £12 without the requirement for a referendum and confirmed grants to PCCs are maintained at the same level as that received in 2017/18.</p> <p>General inflation in the UK has started to increase. CPI is currently 3.0% (Sept 2017). RPI is slightly higher at 3.9%.</p> <p>The 2017 police officer pay settlement included a non-consolidated 1% bonus. This cost £0.7m in 2017/18. The full year effect in 2018/19 is £0.5m.</p> <p>The 2017 offer for police staff has not yet been accepted but is similar to the police officer agreement. The cost of this offer is estimated to be £0.3m in 2017/18 with the full year effect in 2018/19 being £0.2m</p> <p>Base rate was increased for the first time in over a decade recently, raising it from 0.25% to 0.5%. The Governor of the Bank of England has indicated that any future increases will be minimal and gradual.</p> <p>The 4 year medium term financial plan reflects our local 'best estimate' of future</p>

	inflation rates and government grants and contributions.
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- 4.4. The current policy is to maintain general balances at a guideline level of between 3% and 5% of annual net revenue expenditure budget.
- 4.5. It is recommended that the Commissioner agree a strategy to maintain a general reserve at a level between 3% and 5% of the revenue budget.
- 4.6. The use of reserves is a valuable tool to manage cost pressures potentially for more than one year and as issues arise we should be flexible in their creation. A specific example is the potential pressure faced in respect of the anti-fracking protests in Lancashire. As a major incident the force must meet the cost of the operation up to a level equivalent to 1% of the revenue budget (£2.6m) and then apply for assistance via special grant. There is no guarantee that special grant will be provided so any further costs could also fall upon the revenue budget. As an unexpected pressure on the budget the availability of reserves to meet these costs if required is vital for effective financial management.
- 4.7. The level of general balances at 31st March 2018 was £11.782m (4.3% of the 2018/19 Revenue Budget).
- 4.8. Potential requirements to draw down from the general reserve in future years are monitored and reported to the Commissioner throughout the year and will be reflected in the annual review of the reserves strategy.

5. Earmarked Reserves

- 5.1. Reserves are also held to meet specific purposes, they are currently grouped together as "Earmarked Reserves"; they are included here to allow the full picture of financial risks covered to be considered alongside general reserves. The table below sets out the earmarked reserves held.

	Position at 31/3/18 £m
<u>EARMARKED RESERVES</u>	
Reserves held for 'one-off' investment	
Transition Reserve	16.177
PCC Strategic Investment reserve	5.998
	<u>22.175</u>
Forensic Partnership reserve	0.406
Reserves held to support operational policing	
Protective Clothing Reserve	0.471
Vehicle Workshop Reserve	0.040
Wellbeing reserve	0.025
Operational Policing Reserve	0.364
	<u>0.900</u>

POCA Equalisation Reserve	0.640
POCA/Drugs Forfeiture Reserves	0.266
Road Safety Reserves	1.779
Total Earmarked Reserves	26.166
General Reserves	11.782

- 5.2. The Transition Reserve and the PCC Strategic Investment reserve are held to manage the transformation of the Constabulary and to support the Commissioner's capital programme through 'one-off' investments. These reserves have been created in recent years through the early realisation of planned efficiency savings with a strategy to create reserves to enable investment that will continue to deliver programmes that provide further improvements in efficiency and productivity for the organisation.
- 5.3. The Forensic Partnership Reserve is held for investment in the delivery of the Forensics Partnership with UCLAN (University of Central Lancashire).
- 5.4. The Operational Policing reserve is held to meet unexpected and significant demand placed upon the force in any discrete financial year. Such demand might qualify for 'Special Grant' provided by the Home Office, however the rules for special grant require the force to meet the costs of such incidents up to an amount equivalent to 1% of their net revenue budget and then make a claim for any additional costs above this amount. In 2017/18 a significant draw down on this reserve was made to meet costs of the on-going fracking demonstration operation at Preston New Road.
- 5.5. The Protective Clothing Reserve is set aside for specialist protective clothing for officers.
- 5.6. The Wellbeing reserve is set aside to support the constabulary well-being programme for all staff.
- 5.7. The Vehicle Workshop reserve is held for investment in the Vehicle Maintenance Unit (VMU) workshop specialist equipment.
- 5.8. Police and Crime Act (POCA) reserves are held for investment in Crime reduction schemes within the Communities of Lancashire and are created through the seizure of cash and assets on the conviction of criminals.
- 5.9. Road Safety Reserves are held on behalf of Lancashire Road Safety Partnership and are not available for use by the PCC.
- 5.10. The current forecast of the application of these specific reserves in future years is set out in the table below:

<u>EARMARKED RESERVES</u>	Position 31/3/18	Forecast Use of reserves					Forecast position 31/3/23
		2018/19	2019/20	2020/21	2021/22	2022/23	
	£m	£m	£m	£m	£m	£m	£m
Transition Reserve	16.177	7.961	4.229	3.109	0.878		

	July 2018						
PCC Strategic Investment reserve	5.998				1.731	3.579	0.688
Forensic Partnership reserve	0.406	0.406					
Protective Clothing Reserve	0.471	0.050	0.050	0.050	0.050	0.050	0.221
POCA Equalisation Reserve	0.640	0.100	0.100	0.100	0.100	0.100	0.140
POCA/Drugs Forfeiture Reserves	0.266	0.050	0.050	0.050	0.050	0.050	0.016
Vehicle Workshop Reserve	0.040						0.040
Operational Policing Reserve	0.364						0.364
Well-being reserve	0.025	0.005	0.005	0.005	0.005	0.005	-
Road Safety Reserves	1.779						1.779
Total Earmarked Reserves	26.166	8.572	4.434	3.314	2.814	3.784	3.248

5.11. The Home Office has set out guidance for the information to be provided in the PCC's reserve strategy. This guidance requires the classification of reserves held by the PCC as follows:

Funding for planned expenditure on projects and programmes over the period of the current medium term financial plan:	
Earmarked reserves:	£m
Transition reserve	16.177
PCC Strategic Investment Reserve	5.310
Forensic Partnership Reserve	0.406
	21.893

Funding for planned expenditure on projects and programmes beyond the period of the current medium term financial plan:	
Earmarked reserves:	£m
PCC Strategic Investment Reserve	0.688

Resource to meet other expenditure needs in accordance with sound principles of good financial management	
Earmarked reserves:	£m
Protective Clothing Reserve	0.573
POCA Equalisation Reserve	0.639
POCA/Drugs forfeiture Reserve	0.176
Vehicle Workshop Reserve	0.040
Operational Policing Reserve	2.584
	4.012

General reserves	11.984
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Reserves held on behalf of other organisations	£m
Road Safety Reserves	1.779

- 5.12. The application of funding for the capital investment programme including the specific investment reserves shown in the table above is as follows.

	18/19	19/20	20/21	21/22	22/23	Total
	£m	£m	£m	£m	£m	£m
Capital Receipts	0.620	0.430	-	-	-	1.050
Capital grant	1.097	1.097	1.097	1.097	1.097	5.485
Revenue	2.509	2.509	2.509	2.509	2.509	12.545
Reserves	8.083	4.229	3.109	2.609	3.579	21.609
Borrowing	6.388	9.085	0.570	0.570	0.570	17.183
TOTAL	18.697	17.350	7.285	6.785	7.755	57.872

Further detailed analysis of the funding of the programme is shown at Annex 1.

- 5.13. It is recommended that the Commissioner approve the application of specific reserves as set out in the table above and in Annex 1.
- 5.14. From this forecast it is clear that the vast majority of specific reserves will be used by 2022/23. This enables the Commissioner to meet the funding commitments that have been made for the capital investment programme.
- 5.15. As specific reserves are limited it is recommended that the Commissioner review the reserves strategy on an annual basis.
- 5.16. It is recommended that the Commissioner agrees to make contributions into specific reserves if the opportunity arises.

6. Risks

- 6.1. The inability to maintain an adequate general reserve to cover future uncertainties puts the PCC and Force at risk of government sanction and intervention.
- 6.2. The amount of funding for future years' capital programme will be significantly reduced as reserves are utilised and alternative investment strategies will need to be developed.

Capital Investment Programme - Financing

	18/19	19/20	20/21	21/22	22/23	Total
	£m	£m	£m	£m	£m	£m
Capital receipts:						
Network and Security	0.150	0.150				0.300
Device upgrade and replacement	0.200	0.200				0.400
Systems replacement	0.270	0.080				0.350
Capital Receipts	0.620	0.430	-	-	-	1.050
Capital Grants and contributions:						
Network and Security	1.097	1.075	1.075	1.075	1.075	5.397
Device upgrade and replacement		0.022	0.022	0.022	0.022	0.088
Capital grants and contributions	1.097	1.097	1.097	1.097	1.097	5.485
Borrowing:						
West Division HQ	0.083					0.083
Operating base for East division	0.950					0.950
Rationalisation of Hutton estate	1.900	3.325				5.225
Pendle briefing base	0.510	4.240				4.750
Skelmersdale major refurbishment	3.325					3.325
Minor works programme	0.570	0.570	0.570	0.570	0.570	2.850
Borrowing	7.338	8.135	0.570	0.570	0.570	17.183
Revenue and reserves:						
Network and Security	2.365	1.650	1.650	1.650	1.650	8.965
Device upgrade and replacement	0.525	0.853	0.728	0.728	0.728	3.562
Systems replacement	3.201	0.330	0.310	0.310	1.180	5.331
West Division HQ	1.000					1.000
Operating base for East division		0.050				0.050
Rationalisation of Hutton estate	0.100	0.175				0.275
Pendle briefing base		0.250				0.250
Skelmersdale major refurbishment	0.175					0.175
Minor works programme	0.030	0.030	0.030	0.030	0.030	0.150
Vehicle replacement programme	2.856	3.200	2.700	2.200	2.300	13.256
Replacement of specialist equipment	0.340	0.200	0.200	0.200	0.200	1.140
Revenue and reserves	10.592	6.738	5.618	5.118	6.088	34.154
<i>Revenue Contribution</i>	<i>2.509</i>	<i>2.509</i>	<i>2.509</i>	<i>2.509</i>	<i>2.509</i>	<i>12.545</i>
<i>Reserves</i>	<i>8.083</i>	<i>4.229</i>	<i>3.109</i>	<i>2.609</i>	<i>3.579</i>	<i>21.609</i>
	10.592	6.738	5.618	5.118	6.088	34.154

The 2018/19 Capital Investment Programme was approved in this decision by the Commissioner: <http://lancashire-pcc.gov.uk/wp-content/uploads/2018/02/2017-49.pdf>