

Police and Crime Commissioner for Lancashire

Reserves Strategy – 2020/21

1. Introduction

- 1.1. This paper reports 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 PCC's 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 Strategy (MTFS) 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, "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 MTFS 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 "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. Even with the additional resource provided through the national uplift programme the gap between demand and available resources continues to increase.
 - Uncertain central funding after 2020/21 due to proposed changes to the Comprehensive Spending Review (CSR) taking place in 2020.
 - 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.

4. General reserve levels and their use

4.1. Use of General Reserves

4.1.1. The current strategy for general reserves levels is to hold an amount that represents 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.

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.

4.2. 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
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	<p>The PCC and CC make a prudent assumption of future capital receipts.</p>
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>Savings of £2m will be removed from the budget in 2020/21. This means that more than £88m of cash savings have been removed from the base budget since 2011/12. A funding gap of £27m has been identified to 2023/24, which means that over £115m of savings will have been delivered by 2023/24.</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 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 over the last 10 years.</p> <p>As explained above, over £88m of cash savings has already been taken out of the base budget with a further £27m 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 September 2019, Police officers pay was increased by 2.5% and in the latest negotiations, larger increases are being requested in future years, increasing the potential pressure on Police Funding.</p> <p>The Treasury will undertake a Spending Review in 2020 that will determine future years' funding for the sector against a background of demands for savings from government</p>

	<p>departments. This delivers uncertainty, which adds to the potential future risk for funding for Lancashire.</p> <p>Increasingly the burden of funding forces is being passed to local council taxpayers by central government and the ability to continue to increase council tax charges will be tested in future years.</p> <p>The 4-year medium term financial plan reflects our local 'best estimate' of future inflation rates and government grants and contributions.</p> <p>In 2020/21, additional government funding has been provided to deliver an additional 153 officers in Lancashire. This is welcomed, however to deliver the additional officers current staffing levels must be maintained creating a pressure on the budget for pay award.</p>
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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 level of general balances as at 31st March 2020 is forecast to be £10.175m (3.4% of the 2020/21 Revenue Budget).

4.7. 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.

	31/3/19 £m	31/3/20 £m
<u>EARMARKED RESERVES</u>		
Reserves held for 'one-off' investment		
Transition Reserve	14.783	6.300
	14.783	6.300
Forensic Partnership reserve	0.181	0.147
Reserves held to support operational policing		
Protective Clothing Reserve	0.384	0.361
Vehicle Workshop Reserve	0.040	0.040
Wellbeing reserve	0.016	0.016
Operational Policing Reserve	1.915	0.686
	2.355	1.103

POCA Equalisation Reserve	0.547	0.547
POCA/Drugs Forfeiture Reserves	0.300	0.300
Road Safety Reserves	1.974	1.934
Regional collaboration	0.056	-
Total Earmarked Reserves	20.196	10.331
General Reserves	10.175	10.175

5.2. The **Transition Reserve** is 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.

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. **Regional Collaboration reserve** is held in respect of the regional serious and organised crime team.

5.10. The current **forecast application of these specific reserves** in future years is set out in the table below:

<u>EARMARKED RESERVES</u>	Forecast application of reserves							Forecast position 31/3/25 £m
	Position 31/3/20	2020/21	2021/22	2022/23	2023/24	2024/25		
	£m	£m	£m	£m	£m	£m		
Transition Reserve	6.300	-6.300	0	0	0	0	0.0	
Forensic Partnership reserve	0.147	-0.147	0	0	0	0	0.0	
Protective Clothing Reserve	0.361	-0.050	-0.050	-0.050	-0.050	-0.050	0.111	
POCA Equalisation Reserve	0.547	-0.100	-0.100	-0.100	-0.100	-0.100	0.047	
POCA/Drugs Forfeiture Reserves	0.300	-0.100	0	-0.100	0	-0.100	0.0	
Vehicle Workshop Reserve	0.040	0	0	0	0	0	0.040	
Operational Policing Reserve	0.686	-0.686	0	0	0	0	0.0	

Well-being reserve	0.016	-0.016	0	0	0	0	0.0
Road Safety Reserves	1.934	0	0	0	0	0	1.934
Total Earmarked Reserves	10.331	-7.399	-0.150	-0.250	-0.150	-0.250	2.132

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:	31/3/19	31/3/20
Earmarked reserves:	£m	£m
Transition reserve	14.783	6.300
Forensic Partnership Reserve	0.181	0.147
	14.964	6.447

Funding for planned expenditure on projects and programmes beyond the period of the current medium term financial plan:	31/3/19	31/3/20
Earmarked reserves:	£m	£m
NIL	nil	nil

Resource to meet other expenditure needs in accordance with sound principles of good financial management	31/3/19	31/3/20
Earmarked reserves:	£m	£m
Protective Clothing Reserve	0.384	0.361
POCA Equalisation Reserve	0.547	0.547
POCA/Drugs forfeiture Reserve	0.300	0.300
Vehicle Workshop Reserve	0.040	0.040
Wellbeing reserve	0.016	0.016
Operational Policing Reserve	2.003	0.686
	3.274	1.950

General reserves	31/3/19	31/3/20
	£m	£m
General reserves	10.175	10.175

Reserves held on behalf of other organisations	£m	£m
Road Safety Reserves	1.974	1.934
Regional collaboration	0.056	0

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

	20/21	21/22	22/23	23/24	24/25	Total
	£m	£m	£m	£m	£m	£m
Capital Receipts	0.500	0.243				0.743
Capital grant	0.274	0.274	0.274	0.274	0.274	1.370
Revenue	3.447	4.563	5.505	6.505	6.505	26.525
Reserves	6.300					6.300
Borrowing	31.201	30.491	10.350	16.000	8.000	96.042

Financing to be identified		0.443	3.041	5.466	2.041	10.991
TOTAL	41.722	36.014	19.170	28.245	16.820	141.971

5.13. It is **recommended that the Commissioner approve the forecast application of resources to fund the capital programme as set out in the table above.**

5.14. From this forecast, it is anticipated that the specific reserve set aside for funding the capital programme will be used in 2020/21. The Commissioner and Chief Constable will consider alternative sources of funding to meet the financing gap identified in 2021/22 and future years. The PCC and Chief Constable will also consider opportunities to set aside funding in the reserve for future years investment where possible.

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 contribute 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 reduced amount of funding available from reserves for investment in the capital programme will increase the annual requirement placed upon the revenue budget, taking resource from other areas of the business

6.3. Reduced investment through the capital programme may inhibit the ability of the Constabulary to deliver efficient and effective services