

Police and Crime Commissioner for Lancashire

Reserves Strategy – 2022/23

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 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 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 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 level of 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.
 - The ongoing impact of the Covid pandemic and the war in Ukraine on the wider economy and the subsequent impact for funding of the projected economic downturn.
 - The subsequent impact on inflation of the current international situation and the increase in costs for the PCC and Constabulary in 2022/23 and 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 huge inflationary pressures on costs, 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 mitigate the impact of unexpected events or emergencies 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 that forms part of the group's 'General Reserve'.</p> <p>Savings of £7.6m will be removed from the budget in 2022/23. This means that more than £95m of cash savings have been removed from the base budget since 2011/12. A funding gap of £20.5m has been identified to 2024/25.</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 earmarked revenue reserves to help finance specific, ad-hoc, expenditure commitments.</p>

	<p>Appropriations are made to and from these reserves on an annual basis, as required.</p> <p>Finally, general reserves are used as a last resort to manage and fund demand-led spending pressures.</p>
The treatment of planned efficiency savings/productivity gains	<p>The Force has consistently achieved its annual savings target over the last 10 years.</p> <p>As explained above, over £95m of cash savings has already been taken out of the base budget with a further £20.5m required over the next four years.</p>
The financial risks inherent in any significant new funding partnerships, collaboration, major outsourcing arrangements or major capital developments	<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>
The availability of reserves, government grants and other funds to deal with major contingencies and the adequacy of provisions	<p>The PCC has created earmarked revenue reserves and provisions to meet specific expenditure items. These are referred to in more detail in paragraph 5 below.</p>
The general financial climate to which the authority is subject.	<p>The government has not announced the pay award for police officers and staff for 2022/23 however is not unreasonable to assume that a significant pay increase will be awarded, not least reflecting the high level of inflation currently in place in the UK.</p> <p>The Treasury delivered a three-year Spending Review in 2022 providing specific funding allocations to Commissioners for 2022/23 and an indicative total allocation for all forces for 2023/24 and 2024/25. This provides a degree of certainty for future years' funding enabling better informed financial planning. However, the impact of inflation means there are clear uncertainties for planning in respect of future years' cost pressures that will provide the greatest risk to financial planning in the next 12 months.</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 2022/23, government funding has been provided to deliver an additional 204 officers in Lancashire. The PCC has also invested funding from the local council tax precept to add a further 45 additional officers to this increase.</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 2022 is forecast to be £11.465m (3.4% of the 2022/23 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.

	Forecast balance 31/3/22 £m	Forecast balance 31/3/23 £m
<u>EARMARKED RESERVES</u>		
Reserves held for 'one-off' investment		
Transition Reserve	1.048	0
	1.048	0
Forensic Partnership reserve	0.132	0
Reserves held to support operational policing		
Protective Clothing Reserve	0.162	0.112
Vehicle Workshop Reserve	0.008	0.008
Wellbeing reserve	0.017	0
Operational Policing Reserve	1.691	1.691
	1.878	1.811
POCA Equalisation Reserve	0.547	0.547
POCA/Drugs Forfeiture Reserves	0.373	0.373
Road Safety Reserves	2.400	2.400

Total Earmarked Reserves	7.298	5.816
General Reserves	11.465	11.465

- 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 were created 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. It is anticipated the transition reserve will be used in full during 2022/23, however the PCC continues to examine any opportunity to increase this reserve during the year if they should arise.
- 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 31/3/27
	Position 31/3/22	2022/23	2023/24	2024/25	2025/26	2026/27	
	£m	£m	£m	£m	£m	£m	£m
Transition Reserve	1.048	-1.048					0
Capital financing reserve	0.235	-0.235					0
Employee/Public liability reserve	0.685						0.685
Protective Clothing Reserve	0.162	-0.050	-0.050	-0.050	-0.012		0
POCA Equalisation Reserve	0.547						0.547
POCA/Drugs Forfeiture Reserves	0.373						0.373
Vehicle Workshop Reserve	0.008						0.008
Operational Policing Reserve	1.691						1.691
Forensic Partnership reserve	0.132	-0.132					0

Well-being reserve	0.017	-0.017					0
Road Safety Reserves	2.400						2.400
Total Earmarked Reserves	7.298	-1.482	-0.050	-0.050	-0.012	0	5.704

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:	31/3/21	31/3/22
Earmarked reserves:	£m	£m
Transition reserve	1.048	0
Forensic Partnership Reserve	0.132	0
	1.180	0

Funding for planned expenditure on projects and programmes beyond the period of the current medium-term financial plan:	31/3/21	31/3/22
Earmarked reserves:	£m	£m
NIL	nil	nil

Resource to meet other expenditure needs in accordance with sound principles of good financial management	31/3/21	31/3/22
Earmarked reserves:	£m	£m
Protective Clothing Reserve	0.162	0.112
POCA Equalisation Reserve	0.547	0.547
POCA/Drugs forfeiture Reserve	0.373	0.373
Vehicle Workshop Reserve	0.008	0.008
Wellbeing reserve	0.017	0
Operational Policing Reserve	1.691	1.691
	2.798	2.731

General reserves	31/3/21	31/3/22
	£m	£m
General reserves	11.465	11.465

Reserves held on behalf of other organisations	£m	£m
Road Safety Reserves	2.400	2.400

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

	22/23	23/24	24/25	25/26	26/27	Total
	£m	£m	£m	£m	£m	£m
Capital Receipts	1.467	0	0	0	0	1.467
Revenue	6.420	7.620	8.620	9.620	10.620	42.900
Reserves	1.048	0	0	0	0	1.048
Borrowing	12.902	31.636	41.979	25.442	29.111	141.070
Financing to be identified	2.662	8.132	7.344	5.376	2.104	25.618
TOTAL	24.499	47.388	57.943	40.438	41.835	207.742

- 5.13. From this forecast, it is anticipated that the specific reserve set aside for funding the capital programme will be used in 2022/23. The Commissioner and Chief Constable will consider alternative sources of funding to meet the financing gap identified in 2022/23 and future years. The PCC and Chief Constable will also consider opportunities to set aside funding in the transition reserve for future years investment where possible.
- 5.14. As specific reserves are limited, it is **recommended that the Commissioner review the reserves strategy on an annual basis.**
- 5.15. 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