

## **Appendix 3 MPA Treasurer's Statement on the Robustness of the Estimates and the Adequacy of the Proposed Financial Reserves**

### **Reserves and Robustness of the Estimates**

#### **Background**

1. Police Authorities decide every year how much their overall budget requirement is. They base these decisions on a budget that sets out estimates of what they plan to spend on their policing services.
2. The decision on the budget requirement is taken before the year begins and it cannot be changed during the year, so allowance for risks and uncertainties that might increase police service expenditure above that planned, must be made by:
  - a) Making prudent allowance in the estimates for all of the requirements of the MPS, including all its business groups; and in addition,
  - b) Ensuring that there are adequate reserves to draw on if the estimates turn out to be insufficient.
3. Section 25 of the Local Government Act 2003 requires that an authority's chief financial officer reports to the authority when it is considering its budget. The report must deal with the robustness of the estimates and the adequacy of the reserves allowed for in the budget proposals, so that Members will have authoritative advice available to them when they make their decisions.
4. Section 25 also requires Members to have regard to the report in making their decisions.

#### **Robustness of the Estimates**

##### **Reliability/Accuracy**

5. The budget process has involved Members, the Commissioner and his staff and my own staff in a thorough examination of the budget now recommended to the Authority. The estimates have been put together by, or with the involvement of, qualified finance staff and directed and reviewed by the MPS Director of Resources and her Corporate Finance section.

##### **Scrutiny**

6. Budget proposals have been through a rigorous scrutiny within the MPS, including the Management Board and Investment Board and I have received regular briefings from the Director of Resources throughout the construction of the budget. Budget scrutiny meetings have been held by the MPA with all MPS business groups and Management Board members being asked to present their detailed revenue growth and savings proposals for scrutiny to a small group of officers and MPA members, including the Vice Chair to the Authority, and the Chairs of Finance and Resources Committee, Strategic and Operational Committee and Resources Sub Committee. In addition the Chair of the Counter Terrorism and Oversight group attended for the specialist operations scrutiny given his experience in this area. The Authority also received independent advice from a financial consultant (Peter Martin, previously Treasurer to the Authority) who has attended and advised myself and members at the budget scrutiny meetings.
7. At each of these budget scrutiny meetings member's were not only provided with details of revenue and growth proposals for 2010-13, but also details of variances against the budget for 2008/09 and 2009/10, budget pressures and details of

income streams that are at potential risk of withdrawal. The purpose of the scrutiny process was not only to consider the possible impact of the proposed growth and savings on individual business groups but also the impact these would have across business groups.

8. In addition scrutiny meetings were held in relation to the Capital Programme and the balance sheet including a review of reserves. A budget workshop was also held for all members which provided members with the opportunity to scrutinise the budget proposals and to question and seek clarification from MPS officers on specific areas of interest.
9. Finance and Resources Committee and Strategic and Operational Committee have received update reports and a joint meeting was held in September to consider the interim submission to the GLA.
10. The budget submission will be formally considered by a meeting of the Full Authority on 26 November after consideration by the joint Strategic and Operational Policing and Finance and Resources Committee on 19 November. In addition there has been a dialogue with GLA officers.

#### **Achievability and Risks**

11. As detailed in the supporting financial information to the budget and business plan 2010 -13 preparing a budget for 2010/11 based on an increase of 1.25% on net revenue expenditure for 2009/10 (1.4% increase before the use of £4.2M reserves) has been challenging and significant funding pressures have meant that the MPA/MPS have had to make some difficult decisions. There are therefore a number of areas of risk in the budget as detailed below.
12. Olympics – The MPA/MPS continue to work closely with the Home Office to identify additional and opportunity costs in relation to the games. However costs can only be estimated at this stage and, whilst the Home Office is committed to funding additionality, actual additional costs may differ from current estimates.
13. Income generation – The MPA/MPS is becoming increasingly reliant on the generation of income to cover costs. In some cases there is a mismatch between the income targets and costs incurred and/or a risk of withdrawal of income. Remedial action in year would be necessary if income was lower than expected.
14. Specific grant – The current planning assumption is that existing specific grants will continue at the 2009/10 level unless we receive notification of changes. If that proves to be the case then a decision would be required as to whether those services should cease or whether growth in the budget could be accommodated by savings elsewhere.
15. General Government Grant - the budget is being submitted before the formal government grant settlement, however as the police grant 2010/11 has been provisionally agreed as part of the 3-year comprehensive spending review (CSR), the risks of change are low. Future changes to general government grant as a result of the forthcoming CSR will effect the level of savings to be found, as will any decision to withdraw protection for authorities on the grant floor. However as the Mayor has set a budget target based on the increase in the Authority's Budget Requirement rather than including any assumptions about government grant, the GLA currently manages the risk/benefit on variations on general government grant.

16. Capital - The revenue consequence of the capital programme still needs to be fully assessed with regard the decline in the property markets and the Authority's ability to generate capital receipts. The impact could give rise to additional costs of maintaining and keeping compliant old, inefficient property/systems, which may partly be offset by savings from delays in bringing some properties and projects into service. This work will be completed before the budget is approved in March. Any resultant costs will have to be contained within the overall financial limit set by the Mayor
17. Three year planning - The draft budget for 2010/11 requires delivery of £124M savings of which £100.5M are new savings and efficiencies and a transfer from reserves of £4.2M to fund specific growth proposals. There are also significant shortfalls against the guidance targets of £111M for 2011/12 and £145M for 2012/13 over and above reductions of £168.5M and £193.6M already built into those years respectively. Whilst the MPS has a good track record in the delivery of large savings and efficiency packages the task in hand over future years cannot be underestimated. Key to delivering these large scale savings will be the service improvement plan.
18. Economic Climate - The economic downturn could impact adversely on some of the MPA/MPS costs and has resulted in a reduction in the estimates for interest income receivable on deposits. Current planning assumes interest income of £0.8m in 2010/11 compared to the current budget of £2.1m. In 2011/12 and 2012/13 there is likely to be a significant constraints placed on the resources available to the MPA/MPS from Government and partners.
19. Non compliance – The MPS has identified a number of instances of non compliance against contract regulations and is currently undertaking various programmes of work aimed at improving and embedding effective internal control.

#### **Risk mitigation**

20. There are a number of features of the Authority's financial policies, accounting policies and governance arrangements which mitigate financial risks. These include the following:
21. The Authority has regular budget monitoring undertaken by Finance and Resources Committee and progress is also reported to the Mayor and London Assembly (Budget Monitoring Sub Committee) on a quarterly basis. As at Period 6 (to the end of September) there is net overspend forecast of £16.6M against the approved budget. The MPS is looking to manage expenditure down over the remainder of the year and the Authority have agreed to finance costs relating to the Tamil protest (currently estimated to be £7.1M) from reserves if there is still an overspend position at year end. However there may be a need to utilise the budget pressures earmarked reserve at year end to cover any remaining overspend.
22. Risk management has been built into the corporate governance arrangements of both the MPA and MPS so that there is proactive assessment of risks and processes to monitor and manage risks. The supporting financial information to the business plan clearly lays out the MPS approach to risk management and the major risks over the planning period.
23. The MPS have adopted a focussed and structured approach to budget

development in the context of the following key budget principles:-

- Priority to public facing services
- Alignment of resources to MPS wide objectives
- Improve outcomes and minimise unit cost of delivery
- Achievability
- Identification of medium term savings proposals not just focussing on year 1
- Understand the impact of cost reductions elsewhere within the organisation

24. Other areas of mitigation include:-

- An element of the risk of financial loss is transferred externally through insurance arrangements.
- The Authority has appropriate general and earmarked reserves
- The Authority takes a prudent approach to achievability of income and debts due, making appropriate provisions for bad debts.
- The Authority has adopted accruals accounting, in particular making full provision for realistic estimates of future settlements of known liabilities.

### **Future Commitments**

25. The financial projections for future years included in the budget show a significant level of ongoing commitment. However as highlighted above further work is required on the medium term figures in order to judge the implications in the context of the Authority's overall financial position. These will be reported to Finance and Resources Committee who will oversee progress.

26. The Authority's cash flow requirements are forecast and monitored on a monthly basis to ensure stable and predictable treasury management, avoiding unexpected financing requirements.

### **Capital**

27. The MPA has approved a capital strategy which is supported by individual property, information technology and transport strategic plans. Planned expenditure levels are £259M in 2010/11 falling to circa £150M in 2011/12 and 2012/13 with funding coming from government grants, third party contributions, reserves, capital receipts, revenue contributions other third party income and borrowing.

28. In addition to annual borrowing of £40m already identified as being available to support capital investment, the Authority has agreed to borrow an additional £60m over a three year period the proposal is to now spread this over a two year period (£50M in 2010/11 and £10M in 2011/12).

29. In recognition of the continual problem with the underspend against agreed capital budgets, programme governance within the MPS has been reviewed and a Capital Programme Steering Group established to ensure the capital programme delivers against the approved programme. In addition the Authority has reviewed its arrangements to ensure there is proper oversight in place and in future the Resources and Productivity Sub Committee will receive detailed quarterly monitoring reports.

30. The Prudential Code has introduced a rigorous system of prudential indicators, which explicitly require regard to affordability, prudence, value for money, stewardship, service objectives and practicality. This is backed up by a specific requirement to monitor performance against forward-looking indicators and report

and act on significant deviations.

31. In my view the robustness of the estimates has been ensured by the budget process, which has enabled all practical steps to be taken to identify and make provision for the Authority's commitments in 2010/11. Estimates have been prepared in a properly controlled and professionally supported process. The estimates have also been subject to due consideration within the MPA and MPS. However as stated above there is a significant funding gap to be bridged in 2011/12 and 2012/13 and the delivery of the service improvement programme will be key to bridging this. Members will need to ensure that robust arrangements are in place with regard oversight of the service improvement programme and future years budgets.

### **Adequacy of Reserves**

32. Revenue reserves are cash backed balances, held on the balance sheet until they are spent or released for other purposes. As such, they can only be spent once, and are not part of the ongoing base budget.
33. The Authority's balance sheet reserves are held for three main purposes:
- A contingency to cushion the impact of unexpected events or emergencies – this forms part of general reserves;
  - A working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this too forms part of general reserves; and
  - A means of building up funds to meet known or predicted liabilities or to smooth significant expenditure requirements – known as earmarked reserves.
34. The position on the main revenue reserves maintained by the Authority as at 30<sup>h</sup> September (period 6) is set out below:

<b>Description</b>	<b>£M</b>
Earmarked Reserves	195.6
Emergencies Contingency Fund	23.1
General Reserve	47.5
Total Reserves	266.2

35. There is no statutory guidance on reserves, and there has never been an accepted case for introducing a statutory minimum level of reserves, even in exceptional circumstances. CIPFA guidance issued in June 2003 confirms that authorities, on the advice of their treasurers, should make their own judgements on such matters, taking into account all the relevant local circumstances.
36. The Authority's external auditor has responsibility to review the arrangements in place to ensure that financial standing is soundly based. This includes reviewing and reporting on the level of reserves taking into account their local knowledge of the authority's financial performance over a period of time. It is not their responsibility to prescribe the optimum or minimum level of reserves for an individual authority.

### **General Reserves**

37. The General Reserve (£47.5M) and the Emergencies Contingency Fund (£23.1M) total £70.6M some 2.6% of the budget requirement, satisfying the Authority's present policy of holding general reserves of at least 2% of net revenue expenditure provided that there are appropriate accounting provisions

and earmarked reserves, reasonable insurance arrangements a well funded budget and effective budgetary control.

38. Given the confidence, robustness and financial standing that these hard won reserves now gives the Authority, particularly in the difficult financial conditions we are now in and the significant change programme the MPA/MPS is embarking on and potential associated costs, it is felt reserves should be maintained at present levels. Therefore no further action is proposed on these at present although final decisions on the use of the general reserve will be made when the budget is finalised in February/March 2010.

#### **Earmarked reserves**

39. Earmarked reserves have been established to provide resources for specific purposes. There can be a number of reasons why it is anticipated that earmarked reserves will still be unspent at April 2010:
- The reserve was created with the intention of being released over a number of forthcoming years (e.g. property related costs),
  - The reserve was prudently created to deliberately cover potential future years' liabilities (e.g. insurance fund),
  - The reserve was created to allow revenue account surpluses to be carried forward (e.g. Proceeds of Crime Act).
40. As part of the budget scrutiny process a review of the usage and need of the present earmarked reserves has been undertaken with the MPS.

#### **Latest outlook for earmarked reserves**

41. A summary of the earmarked reserves as at 30 September 2009 (Period 6) is provided below:

Category	Opening Balance 2008/09 £M	Movements in year £000	Closing Balance 2008/09 £M	Movements in Year 2009/10 as at period 6 £M	2009/10 balance as at period 6 £M
Accommodation strategy/property related costs	34.0	3.5	37.5	0	37.5
Operational Costs	76.5	22.7	99.2	-2.4	96.8
Revenue support to Capital rephasing	9.8	4.8	14.6	-2.0	12.6
Major change programmes	16.1	12.3	28.4	-0.3	28.1
Budget pressures	9.4	10.2	19.6	0	19.6
MPA Initiatives	0.9	0.2	1.1	-0.1	1.0
<b>Total</b>	<b>146.7</b>	<b>53.7</b>	<b>200.4</b>	<b>-4.8</b>	<b>195.6</b>

42. As reported previously, as at period 6 there is a forecast overspend within the revenue budget of £16.6M, whilst the MPS are currently looking at how expenditure levels can be managed down any overspend at year end will need to be met from the budget pressures reserves which will obviously impact on the overall level of reserves held by the organisation as at March 2010. In addition the Authority has already agreed to fund expenditure associated with the Tamil protest (currently forecast to be £7.1M) from the budget pressure reserve if there is still an overspend position at year end. These and any further draw down of

reserves during 2009/10 will be approved by Finance and Resources Committee at the appropriate time.

43. Therefore for the reasons outlined above in relation to the general reserve it is not felt appropriate to release reserves for alternative purposes at this point in time.

**Provisions**

44. A review of provisions has been undertaken. The remaining provisions are also estimated to be sufficient to meet known liabilities, including in particular the provision for insurance liabilities.