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 MPA/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 Group Finance section.

Scrutiny

6. Budget proposals have been through a rigorous scrutiny within the MPS, including the Management Board. Both myself and the Chair of the Authority 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. This included the Chair and Vice Chair to the Authority, and the Chairs of Finance and Resources Committee, and Resources and Productivity Sub Committee. The Chair of the Counter Terrorism and Oversight group attended for the specialist operations scrutiny, and the Chair of the Estates Panel attended for the Property Services scrutiny given their experience in their respective areas.

7. At each of these budget scrutiny meetings member's were not only provided with details of revenue and growth proposals for 2012-15, but also details of outturn for 2010/11 and current forecasts for 2011/12, plus any other issues that were seen to be key to the budget proposals. 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 is planned for all members, providing members with the opportunity to scrutinise the budget proposals and to question and seek clarification from MPS officers on specific areas of interest.

9. Budget proposals were also scrutinised by the GLA Budget and Performance Committee as part the Committee's scrutiny of the Mayor's budget proposals.

10. In addition there has been a dialogue with GLA officers throughout the process.

Achievability and Risks

11. The budget and business plan for 2012 – 15 has been prepared based on a net expenditure of £2,599.4M a reduction of £113.6M (4.2%) from 2011/12 reflecting what continues to be a challenging financial landscape. Taking into account new growth of £75.3M, additional savings (over of and above those currently included in the Policing London Business Plan for 2011/14) totalling £168.1M are needed to deliver a balanced budget. There is however currently a budget gap of £85.5M that needs to be bridged to ensure the MPA/MPS has a balanced budget for 2012/13.

12. The budget has been developed in what continues to be a challenging landscape, both financially and operationally and there are therefore a number of key areas of risk in the budget as detailed below.

Medium Term Financial Plan

13. Taking account of new and additional growth the draft budget and business plan requires delivery of £168.1M savings in 2012/13 rising to £408M in

2014/15. These figures include savings of £85.5M in 2012/13 rising to £226.2M in 2014/15 that still need to be identified. This is in addition to the £323M committed savings included in the 2011/14 Policing London Business Plan.

14. Whilst the MPA/MPS have a good track record in the delivery of large savings and efficiency packages, the task in hand over future years cannot be underestimated. The savings programmes have ambitious targets and some of the corporate initiatives may be subject to challenge. Therefore to recognise the risk associated with the delivery of these savings, a resilience provision of £25M has been included in the budget.

Recent London Disturbances

15. The current forecast for the additional costs of policing the recent London disturbances (Operation Kirkin) and the subsequent investigation (Operation Withern) is £90m. In addition, the latest value of claims received under the Riot Damages Act (RDA) is £198m (£16m of uninsured claims and £182m of insured claims). There is also an additional £91m of claims related to non-RDA activity such as consequential losses. The overall cost is however expected to rise as some claims at present only include provisional amounts.

16. The Home Office have previously confirmed that the cost of claims from uninsured businesses and individuals will be reimbursed in full .However for the remainder of the costs a special grant application will need to be submitted to the Home Office.

17. In line with the Prime Ministers statement to the House of Commons on 11th August that "The Government will ensure the police have the funds they need to meet the cost of any legitimate claims" the current planning assumption is that these costs will be met in full by the Government. However in line with the special grant process the Authority could be asked to contribute up to 1% of its net expenditure to the costs, creating a potential liability of £26M, which would need to be met either from reserves or through increased savings. This 1% contribution can be waived in part or in total by the Secretary of State.

Funding

18. The financial landscape continues to be challenging. Whilst the Comprehensive Spending Review provided some clarity in terms of resources over the medium term, there is still uncertainty about the exact level of funding available to the MPA/MPS. This includes the element of general grant received from Communities and Local Government, as the amount of grant is only confirmed to 2012/13.

Operational risk

19. In addition to the need to continue to reduce crime levels and deliver public

confidence and satisfaction in policing there will be an increased requirement for public order policing in 2012/13. This is due in part to a significant increase in public events including the Queens Diamond Jubilee and those around the London 2012 Olympics, but also potentially in response to a continued increase in public protest as seen in 2011/12.

20. The Terrorism Prevention Investigation Measures Bill due to be enacted in December 2011 has the potential to impact on the way in which services, especially counter terrorism are delivered.

Olympics

21. This is a major programme of work and the MPA/MPS are working closely with the Government to ensure resources and service capacity is adequate to support the delivery of a safe and secure London 2012 Games.

Income generation

22. The MPA/MPS are becoming increasingly reliant on third party income from partners, with some £0.4bn of spend now supported by partnership funding. As finances become tighter there is an increasing risk that this income will be withdrawn, which cannot necessarily be met by a corresponding reduction in costs.

Non compliance

23. There is a need to ensure that governance arrangements remain fit for purpose during a time of significant change including the transition to MOPC and adapting to the new landscape for policing.

Treasury Management

24. All MPA investments are made in accordance with the Authority's Treasury Management Investment Strategy and comply with the CIPFA Code of Practice for Treasury Management in local authorities. The Strategy reflects prevailing financial market conditions and the advice of MPA treasury advisors Arlingclose, with due regard to the overall credit quality of available investment opportunities.

Redundancy Costs

25. The approved Policing London Business Plan included a reduction in police staff of 1,048 and the current budget proposals will reduce the police staff establishment by a further 555 staff. There will be additional costs associated with the new programme of voluntary departures which are well in excess of the current level of available funding.

Capital Programme

26. The main uncertainty to the capital programme concerns its funding over the

plan period with regards grant, revenue contributions to capital outlay, reserves, capital receipts and rising interest rates.

Risk mitigation

27. The Authority's financial policies, accounting policies and governance arrangements contain a number of features to mitigate financial risks. These include the following:

28. 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. Regular monitoring will continue under the new governance arrangements.

29. As at Period 6 (to the end of September) there is net underspend forecast of £5.7M against the approved budget. The additional costs of the recent public disturbances are excluded from the forecast as they are subject to negotiation with the Home Office as outlined above.

30. 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. This now includes a more detailed assessment of financial risks. Corporate Governance Committee takes an active role in reviewing these.

31. The MPA/MPS is working to shape a future policing model for the coming years in a way that reflects it's significantly reduced budget and the emerging demands on it's services. In doing this they are reviewing the core functions and structures that enable them to deliver their objectives, protecting their operational capability and the ability to provide a rapid deployment of capacity for the new challenges of public order policing.

32. To deliver this change the MPA/MPS continue to be focused on reducing the costs of inanimate objects and non-staff costs quickly, delivering an effective business and operational model at least cost through process improvements, shared services, exploring outsourcing and joint ventures, and only then reducing numbers of operational officers and PCSOs whilst mitigating the loss in capacity.

33. Other areas of mitigation include:-
    - An element of the risk of financial loss is transferred externally though 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

34. 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 to bridge budget gaps in all three years.

35. 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.

36. 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 2012/13. 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 are large scale savings to be delivered and a funding gap to be bridged in all three years. The MOPC will need to ensure that there continues to be robust governance arrangements in place with regard oversight of the savings programmes and future years' budgets.

Adequacy of Reserves

37. Revenue reserves are 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.

38. 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.

39. 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 November 2008

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.

40. 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

41. This reserve was established to provide cover for emergencies and contingencies and together with the emergencies/contingencies fund, is to be maintained at least at 1.5% of the net revenue budget as agreed as part of the 2011-14 budget planning process. This is on the basis that there are appropriate accounting provisions and earmarked reserves, reasonable insurance arrangements a well funded budget and effective budgetary control in place. As at 31st March 2011 the Authority had general reserves of £70.6M, some 2.5% of the budget requirement.

42. Current proposals will reduce this to £42.6M by the end of 2013/14, 1.5% of the net revenue expenditure, in line with the recommended policy of maintaining general reserves of at least 1.5%.

43. This however assumes that we will receive funding in full from government for the cost of the recent public disturbances. If the MPA are required to use the general reserve to contribute to the costs the planned use of the reserve will need to be reviewed and steps taken to reinstate the general reserve back to a acceptable level.

44. Based on the assumption outlined above in para 43, in my opinion the proposed approach remains prudent and the Authority will still have adequate reserves in place with general reserves totalling £42.6M in 2013/14, and further balance sheet resilience from a prudent approach to the establishment of earmarked reserves which are currently forecast to total £53.2M by 2013/14. This assumption will need to be reviewed if full funding from government is not forthcoming for the costs of the recent public disturbances.

45. The position on general fund balances will be kept under constant review with the aim of building up future resilience as permanent reductions are implemented.

Earmarked reserves

46. 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 2012:

- 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).

47. 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. A more detailed review will be undertaken by the Treasurer as part of the closing of the accounts process for 2011/12.

48. As at 31st March 2011 the Authority had earmarked reserves of £199M. However it is anticipated that there will be significant draw-downs over the next two financial years with an estimated balance of £53.2m by the end of 2013/14. The MPA/MPS is also likely to require approximately £50m for the next phase of the voluntary redundancy programme and therefore any unused earmarked reserves will need to be set aside for this purpose.

Provisions

49. 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.