

**POLICE AND CRIME PANEL – 10 NOVEMBER 2014**

**MEDIUM TERM FINANCIAL PLAN (MTFP) UPDATE 2014-15**

**REPORT BY THE POLICE AND CRIME COMMISSIONER**

**PURPOSE OF THE REPORT**

*To update Members on specific areas of the Medium Term Financial Plan as requested at the previous meeting of the Panel.*

**1. BACKGROUND**

- 1.1 The Medium Term Financial Plan for the period 2014-15 to 2016-17 was presented to the Police and Crime Panel in February 2014. Updates were provided in a number of areas at the last meeting of the panel on 11 September.
- 1.2 Members requested updates around specific areas to be presented to this meeting and these are set out in this report.
- 1.3 The full Medium Term Financial Plan will be presented to the next meeting of the Police and Crime Panel on 11 December 2014.

**2. INSURANCE**

- 2.1 Dorset Police is largely self insured, with the requirement to pay the first £25,000 to £50,000 of most insurance claims (the 'deductible'), depending on the type and year of the claim. Insurance claims vary widely in the amount of time between the claim being raised and the resolution, including any settlement. In particularly complex cases this process can take many years.
- 2.2 An amount is set aside in each financial year's budget to cover the cost of insurance relating to that year – i.e. relating to incidents that occurred in that year, which are not necessarily the claims made in that year as historic claims can also be made which relate to previous years. This budget allocation is used to fund claims that relate to, and are settled in that specific year, and any residual is put in a reserve, and earmarked for future payments relating to that year.
- 2.3 As such, an insurance reserve exists which comprises amounts held covering insurance risks for each previous year. This can cover claims that are expected, as well as claims that have not even yet been raised. Funds from this reserve are transferred into revenue each year to cover prior year settlements.
- 2.4 There are four main areas of insurance – motor, public liability, employer's liability and property. A brief explanation of risks covered by each is shown below:

- Motor insurance relates to claims for damage to or loss of Dorset Police's vehicles, and claims from members of the public for injury or damage to property caused by Dorset Police vehicles.
- Public liability indemnifies Dorset Police in respect of legal liability for death, personal injury or illness to third parties and / or damage or loss to a third party.
- Employer's liability indemnifies Dorset Police in respect of legal liability for death, personal injury or illness to employees where this arises in the course of their employment.
- Property insurance covers claims for damage to or loss of Dorset Police's own property arising from weather, accidental action, criminal damage, fire, etc.

2.5 Dorset Police uses the services of an insurance broker, currently Marsh Ltd, to provide insurance expertise and to select and work with insurance providers. The costs of insurance in 2014/15, and the level of deductible, for each category of insurance is shown below:

	Premia £000's	Deductible £000's	Revenue Claims Budget £000's
Motor	153.2	25	406.4
Employer's Liability	132.9	50	144.4
Public Liability			172.2
Property	50.3	50	1.6
Other Insurance *	44.7	variable	15.4
Brokers and Claims Handling Fees	45.2	n/a	n/a
	<b>426.3</b>		<b>740.0</b>

\* 'Other' Insurance includes marine, engineering & inspection, fidelity, combined travel and other minor policies

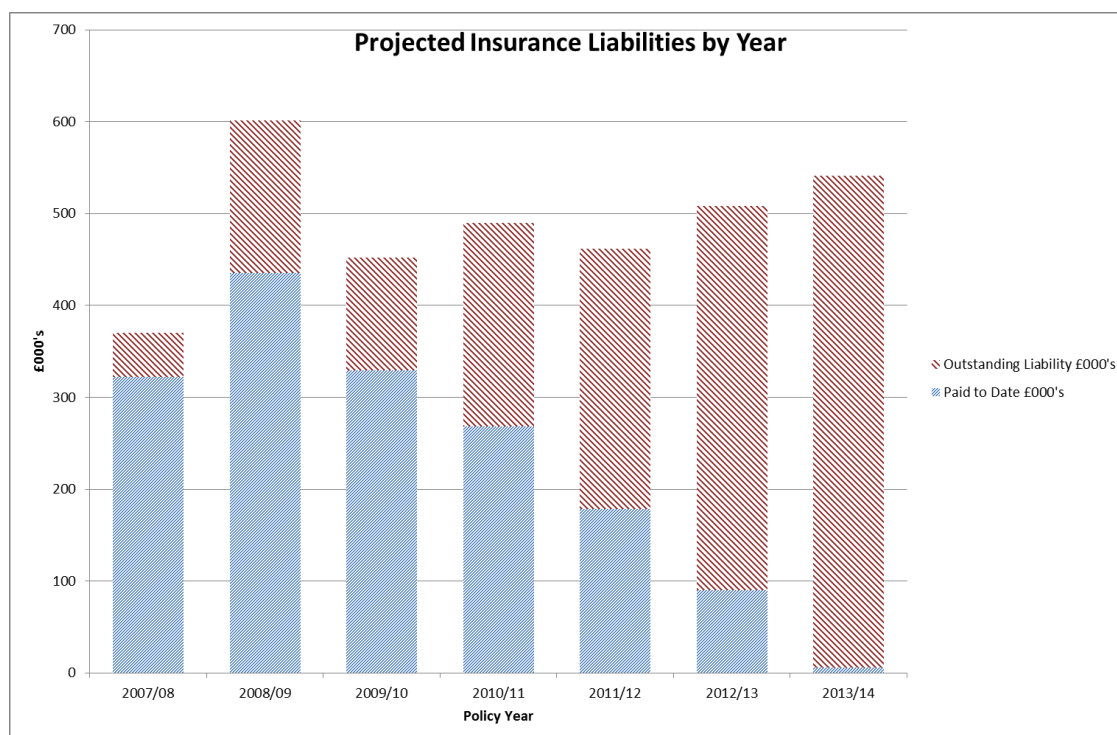
2.6 A recent actuarial review of the Insurance Reserve, for the years up to and including 2013/14, identified the total amounts paid to date by year, and also made an assessment of any known, and potentially unknown, future claims and ultimate settlements.

2.7 This review determined that the total required amounts for each of the last seven insurance years have averaged £489,000, although the trend has been for higher payments, but reducing numbers of claims. The 2013/14 projected total insurance claim requirement is £540,000. These figures compare with the current annual budget of £740,000, and suggest that a *reduction of around £200,000* could be made in this annual allocation. This was reported to the last meeting of the panel, along with a number of other potential savings areas.

2.8 A number of payments have already been made against this total projected requirement. The amount already paid (up to the date of the actuarial report), and the potential outstanding liabilities, as assessed by the actuaries are shown below:

Policy Year	Total Projected Requirement £000's	Paid to Date £000's	Outstanding Liability £000's
2007/08	369	321	48
2008/09	601	435	166
2009/10	452	329	123
2010/11	490	268	222
2011/12	462	178	284
2012/13	509	90	418
2013/14	540	6	535
<b>Total</b>	<b>3,424</b>	<b>1,628</b>	<b>1,796</b>
<i>Average</i>	<i>489</i>		

The below chart shows the projected annual liabilities for the last seven years, and demonstrates the trend for increasing overall payment level.



- 2.9 These figures do not include any provision for uninsured losses, which can include judicial reviews, employment tribunals, or the potential for incidents that are not covered by any existing policies. In addition, it should be noted that the assessment of future liabilities is not necessarily a reflection of past claims history due to the continually changing risk profile of Dorset Police.
- 2.10 The total balance on the Insurance Reserve at 31 March 2014 was £3.5m. This compares with the expected outstanding liability of £1.796m. Even after taking into account uninsured losses, and other risks, it is clear that there is scope to reduce this reserve. This will be taken in to consideration when setting the budget for 2015-16.
- 2.11 For any large / catastrophic claims made against the external insurance policies which are more than the policy excess, the income is set against the cost of addressing the issue – i.e. repair / rebuilding / replacement costs. It is therefore not shown separately in the accounts.

### 3. SPECIFIC RESERVES

- 3.1 It is necessary to consider the type and level of Specific Reserves held as part of this review of the MTFS. The reserves held by Dorset Police are held in the name of the Police and Crime Commissioner for defined purposes, and Dorset Police have the second lowest level of reserves and balances in England and Wales. The total projected reserves over the period of the MTFS is shown below:

	<b>NB: Projected Balance of Reserves Held</b>				
	<b>31/03/14</b>	<b>31/03/15</b>	<b>31/03/16</b>	<b>31/03/17</b>	<b>31/03/18</b>
	<b>£m's</b>	<b>£m's</b>	<b>£m's</b>	<b>£m's</b>	<b>£m's</b>
Insurance Reserve	3.5	2.1	2.0	1.9	1.8
PFI Reserve	0.0	1.4	1.3	1.2	1.1
Pensions Reserve	0.2	0.2	0.2	0.2	0.2
Major Operations Reserve	1.2	1.6	1.6	1.6	1.6
Change Management Reserve	0.9	0.9	0.9	0.0	0.0
Other Reserves	0.4	0.0	0.0	0.0	0.0
	<b>6.2</b>	<b>6.2</b>	<b>6.0</b>	<b>5.0</b>	<b>4.8</b>

#### Insurance Reserve

- 3.2 As detailed in Section 2 above, the latest actuarial review of the insurance fund indicated that the value of the insurance liabilities were highly unlikely to exceed the value of the reserve held. The review stated that approximately £1.8m should be sufficient to cover our current liabilities. As such, it may be possible to take an increased risk on this reserve, and transfer some of the funds held for insurance purposes to another reserve.

#### PFI Reserve

- 3.3 The funding of PFI over the contractual life involves an annual payment, of which an element is indexed, offset by a fixed annual grant from HM Treasury. The net impact of this gives a potential for the annual net cost to increase at a faster rate than the underlying inflation and faster than the annual increase in the police base funding. As such, a PFI reserve has been created to even the profile over the life of the contract.
- 3.4 The Joint PFI with Dorset Fire and Rescue involves the sharing of the contract cost and treasury grant which is clearly set out in the inter authority agreement. The Agreement taking full account of the respective share of accommodation, usage patterns and initial capital injections.

#### Pensions Reserve

- 3.5 The pension reserve exists as a precaution should the number of ill health retirements in a year exceed the number budgeted in revenue (and is recommended practice by the Home Office). The reserve of £203,000 as it stands covers approximately three ill health retirements. The revenue budget covers approximately seven ill health retirements.
- 3.6 In the event that actual revenue expenditure exceeds the budget in this area, the first option will be to fund the shortfall from other revenue budgets. However, this reserve exists as a one off sum in the event of an exceptional demand. The actual number of ill health retirements for the last five years and the current year to date is shown below:

2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
3	5	4	6	9	13

### Major Operations Reserve

- 3.7 Dorset Police holds a specific reserve to be used in the event of a significant major operation. Major operations are generally managed through revenue, where an annual budget is made available for the costs of such operations – primarily overtime and forensic services. The reserve exists to provide a contingency should the total spend on major operations exceed the revenue allocation.
- 3.8 The 2014/15 revenue budget is £782.3k. The revenue allocation underspent by almost £400k in 2013/14. The nature of major operations is unpredictable. It is not possible to know how many operations will occur in any year, or of what scale. However, this reserve means that it may be possible to take a higher degree of risk in the revenue budget.
- 3.9 The Home Office offer potential sources of funding in certain circumstances to cover urgent costs arising from unexpected major incidents or operations where costs exceed 1% of the total annual budget. However, these schemes do not present an automatic entitlement to funding and any bid against either scheme would be decided on a case by case basis.
- 3.10 Due to the nature of the reserve, it should ideally be maintained at a level no less than 1% of the annual Dorset Police budget. In the event funding is withdrawn from this reserve, a plan to reinvest in the reserve to this level will be built into the financial strategy.

### Change Management Reserve

- 3.11 This reserve exists to allow a source of funding for the one off costs of change, such as costs associated with any future workforce reductions.
- 3.12 The restricted recruitment of police staff, while necessary, is increasingly resulting in external recruitment for specialist posts. As the primary mechanism for Dorset Police to reduce costs is reducing staffing numbers, it is therefore likely that the Force will need to use other measures, such as redundancy, to achieve this. Such measures will have an associated cost, which have the potential to be substantial, and this reserve may assist with this process.

## **4. GENERAL BALANCES**

- 4.1 The target level of general balances has remained at 3% for many years now, as originally advised by the Audit Commission. This figure is reviewed annually to ensure the target continues to take account of the financial risks facing Dorset Police.
- 4.2 The primary purpose of general balances is to support in-year revenue budgets in the event of significant, unplanned cost pressures. This may result from a reduction in income (such as a significant in year reduction in grant income such as that experienced in 2010/11), the non achievement of savings plans, unforeseen significant expenditure, and so on. Funding for such financial challenges would first be sought from existing revenue budgets and a small contingency is held in revenue to address a certain level of major incidents and events. However, if there was insufficient in year funding available to address particular cost pressures, general balances would be called upon.

- 4.3 General balances, after funding known commitments from previous years, currently stand at £3.4m (3.0% of the 2014/15 budget).
- 4.4 The requirement to hold 3% in general balances is revalidated annually as part of the MTFS process by quantifying known risk and providing assurance around levels of general reserve. While every effort has been made to identify known risks, there is clearly the issue of 'unknown risks', which is part of the rationale behind the 3% target. However, as further risks are taken in other areas of the budget in order to meet the budget gap, the level of general balances becomes increasingly important.
- 4.5 Whilst every effort is made to be as objective as possible in this process, it is by its nature a subjective assessment. The possibility exists for more than one of the risks to occur in any year which could completely exhaust the balance. The contingency, in the event that additional cash were required, would be to call on specific earmarked reserves, although any use of the reserves in this way would clearly require an urgent reassessment of the MTFS.
- 4.6 Continual financial monitoring and environmental scanning is used in order to ensure that the Commissioner and Chief Constable have the maximum notice to plan and instigate any corrective action. Any potential risks that are identified are highlighted as appropriate in Budget Monitoring reports, Budget reports and Financial Strategy reports to the Joint Executive Board.

## **5. FINANCIAL RISKS**

- 5.1 A risk assessment is undertaken annually as part of the budget setting process and is subject to review periodically throughout the year. A copy of the most recent analysis is attached at Appendix 1.
- 5.2 There are several risks inherent in the MTFS, primarily relating to the required level of savings not being achieved and incorrect assumptions.
- 5.3 There is a significant variance in projected shortfall depending on the assumptions taken in respect of future precept increases, pay awards, future leavers etc. The MTFS is based on the 'most likely' projections, but these are far from assured. The projected shortfall clearly has a direct impact on future resourcing levels and is therefore monitored very closely.
- 5.4 The main risks within the MTFS are:
- Further funding / income reductions. Indicative figures for future years grant funding have been derived from public documents such as SR 2013 and HM Treasury's annual Budget reports, as well as using feedback on interpretation from other forces, ACPO Finance and Business area, and other sources. However these projections are clearly not guaranteed. In addition, current income levels may be difficult to sustain in the current climate. This includes income from the Driver Awareness Scheme. Changes in income or funding will be monitored and corrective action taken as necessary. This could include increasing charges if appropriate and justified, seeking further savings elsewhere, or extending the recruitment restrictions.

- Fewer leavers than anticipated. If the number of actual leavers is significantly below the assumptions within the MTFS, the base budget requirement will increase, increasing the shortfall and lengthening the projected recruitment restrictions. The reverse is also true for increased numbers of leavers. Estimating leavers is increasingly difficult due to the removal of enforceable leaving dates on the basis of age. The number of leavers is monitored monthly and, if necessary, the further use of workforce exit mechanisms such as the voluntary severance scheme or redundancy will be considered.
- Projected non-staff savings not being achieved.
- Withdrawal of partnership funding. The current financial environment is putting partner agencies under increased pressure. This pressure could manifest itself as withdrawal of funding, higher demands being placed on Dorset Police, or both. However, income from partnerships is already at a very low level which slightly reduces the impact of further funding reductions. The main risk remains funding of the Road Safe Partnership.
- Workforce structures not meeting available resource. It is clear that under any future funding scenario, the resources of Dorset Police will be significantly reduced over the next three years. The current structure is designed to be scalable to adapt to the final reduced level of resource. However, delays in matching the structure to the available resource, including necessary process changes, could lead to performance issues. This risk is managed by the Joint Executive Board.
- Significant cultural change required. Officers and staff will continue to be affected by the projected resourcing levels both professionally and personally. Take home pay will continue to reduce in real terms, and - for some - in cash terms, on top of which there are likely to be further changes to working patterns, reduced opportunities for overtime, greater financial controls on procurement, restrictions on travel and so on. To achieve the required level of savings, and maintain performance, the Force requires absolute 'buy in' from the entire workforce. This will require significant cultural change, including revised expectations and an openness to change. The pro-active investment in leadership over the last few years will be called upon to mitigate this risk.
- Cash flow issues. Although routine revenue cash flow is adequately covered by grant, precept, and other income, there are other extraordinary issues over the period of the MTFS that will need careful monitoring. Specific reserves and general balances will stand at approximately £8m - £9m (excluding capital cash flow) for most of this period, although this figure is currently reduced by the remaining monies owed to Dorset Police in respect of Icelandic investments. While it is not currently expected that external borrowing will be required, this risk will be closely monitored.

## **6. ICELANDIC BANKS UPDATE**

- 6.1 Dorset Police Authority was one of over 120 local authorities who have funds on deposit with Icelandic banks. The total sum at risk nationally has been assessed at approaching £1 Billion.
- 6.2 Between 26 June and 3 September 2008, Dorset Police Authority made three temporary loans to two Icelandic banks, Landsbanki, (two loans totalling £5 Million) and Heritable (a UK subsidiary, one loan of £2 Million), totalling £7 Million. These were fixed term loans at interest rates of between 5.72% and 6.22% repayable between October and December 2008. At the time these loans were made, both banks met the criteria set by the Treasury Management Policy. These loans have now been passed on to the PCC.

6.3 The current position on each bank is shown below:

#### Heritable

6.4 A claim was registered at an early stage with the administrators, Ernst & Young for £2,035,104 being the principal outstanding, and interest accrued to 7 October 2008.

6.5 Ernst & Young, the administrators have made fourteen separate repayments to date; the most recent of these being received on 23 August 2013. The total amount returned to date is £1,913,351 or 94.01% of the claim. The impairment made by the PCC was £1.8M in total.

6.6 The administrator's original estimates of recovery had been in the region of 86-90p in the pound but based upon the progress of the administration to date and assumptions in respect of predicted future performance suggest a base case return to creditors of 94 pence in the pound. The latest payment took the total to in excess of this and an update on future dividends is expected in the coming months. It is anticipated that a further small payment might be forthcoming. At present, legal proceedings are still ongoing and if successful a full 100p in the pound could be achieved.

#### Landsbanki

6.7 The Office of the Police and Crime Commissioner also have deposits frozen with Landsbanki. This process has progressed significantly slower than Heritable as it was conducted under Icelandic law. There has been a significant amount of work on behalf of local authorities by Bevan Brittan, Kent County Council and the London Borough of Barnet. The authorities are members of the "Resolution Committee" that has been placed in charge of running Landsbanki by the Icelandic Financial Services Authority (the "FME").

6.8 The Winding Up Board of Landsbanki released the first payment received by the Authority in Pounds Sterling, Euros, and US Dollars between 17 and 21 February 2012, totalling £1,476,003. A second payment was received on 29 May 2012 for £619,768, a third payment was received in Pounds Sterling, Euros, and US Dollars on 10 October 2012 for £295,537 and a fourth payment was received in Pounds Sterling, Euros and US Dollars on 13 September 2013 totalling £254,609 giving a total received of £2,645,916. This took repayments to date to around 54% of the claim total.

6.9 Since the last repayment, the bank has realised significant further sums through the sale of assets but no further distributions have been made. Any distributions require approval by the Winding up Board and Icelandic Government but changes in senior personnel and political issues appear to have prevented any further payments being agreed at this stage.

6.10 Although the banks still appears to have sufficient assets to cover a full distribution, there is some uncertainty as to when this will happen. It is likely to be over the next 4-5 years.

6.11 A number of authorities have now sold their claims to a third party to remove the future uncertainty. Dorset PCC is in the process of finalising a sale of our claims against the insolvent estate of LBI. We are not able to disclose any further information until the claim has been formally transferred and the proceeds of sale received.



- 6.12 The cash repayments are not a windfall to Dorset PCC as, following national LAAP guidance issued by CIPFA, we are accounting for full repayment, albeit over a significant time period. The actual benefit to Dorset PCC of repayment or sale of the claim will be that the cash balances will be higher which will enable higher returns to be received through Treasury Management activities.

**RICHARD BATES**  
**TREASURER TO POLICE AND CRIME COMMISSIONER FOR DORSET**

Members' Enquiries to: Richard Bates, Treasurer (01305) 228548

Press Enquiries to: Fiona Napier, Media and Communications Manager (01305 223619)

MEDIUM TERM FINANCIAL STRATEGY 2015/16 – 2017/18

Appendix 1

ANALYSIS OF GENERAL BALANCES REQUIREMENT

Description	Narrative	Estimated Maximum Risk	Local probability	National Probability	%	Reason	Nominal Allocation	Financial Effect Managed Through
<b>Exceptional major operations</b>	Potential for significant major operation, in excess of 1% of Force budget. 1% held on separate reserve. Home Office will consider additional funding for operations costing more than 1% of base budget, and the Government's may provide funding over 1% in a single year, but this funding is not guaranteed. The Home Office expects forces to make some provision for exceptional operations.	£8,000,000	No operations exceeding 1% of budget in a single year (excluding security operations for Olympic Games and political conferences) since 1995. Corporate manslaughter (from risk register) provides additional risk	Three payments to forces of similar budget size known of, each covering approximately 50% of total additional costs. Some additional funding made available for policing riots in 2011, and more recent protests.	25%	Although grant may be payable above 1% there is no guarantee. General balances allows for cash flow and any underfunding	£2,000,000 {£1.2m reserve plus 800k general balances}	Major Operations Reserve / General Balances
<b>Incorrect pay award assumption</b>	September pay award for police and police staff mean that the budget is often based on estimates. Due to the size of the pay budgets, an under estimate would have a significant affect both in the current and following years. The annual uplift in the pay and designated allowances of police officers below the rank of Chief Officer is currently determined by a formula linked to movements in non-manual private sector pay. Although this gives a degree of stability it is generally not possible to pre-empt their calculations because of the time delay. For 2013 - 2015 public sector pay award have been published (1%) so little risk in those years. However, beyond that risk remains.	£481,000	Since 1995 there have been three cases of overestimation, and one of underestimation. The remainder were correct. The maximum error (plus or minus) was 0.5%. The risk of over budgeting is of course similar to the risk of under budgeting	No indication nationally of pay award beyond 2015.  Local government pay offer now made in excess of 1% (2.2% covering 2 years)	50%	1% budgeted for 2013 to 2015. Beyond that assumed maximum error with be 0.5% and that will not occur each year.	£240,500	General Balances
<b>Reductions in Police Grant</b>	Over the past 4 years we have seen a reduction in funding of 20%. This included in year cuts in 2010. The latest spending review for Police only covered 2014-15. There is therefore no agreed figure of 2015-16 and beyond. With economic uncertainty in Europe and	£62m	In year changes occurred in 2010 after the last general election	No official indication of future funding levels beyond 2014-15. CSR expected in July 2015	2%	Allowance for potential reductions	£1.24m	General Balances

	wider, the risk of in year funding changes still exist. With the general election taking place in May 2015, there is even greater risk and there is likely to be an additional Comprehensive Spending Review in July 2015.							
<b>Fewer staff leavers than budgeted</b>	Each year, an assumption is made around the number of officer / staff leavers. Staff can be controlled to some extent but police officers cannot be removed from post on compulsory basis.	£3m	Downsizing organisation and savings are partially reliant upon no. of leavers	National rulings around use of A19 prevent compulsory retirement of police officers	20%	Savings required from staff reductions could be delayed	£300,000	General Balances
<b>Reductions in security grant</b>	This grant is subject to annual change. The current pressure on specific grants generally presents the possibility of further significant annual variations. This proposal allows smoothing of change between years	£1,717,800	In year £40,000 reduction in 2010/11, although no such reduction since. However possibility of significant reductions in specific grant funding generally for future years remains	Other forces also affected, but increased national pressure on grant funding means quantum available anticipated to reduce	15%	May be mitigated by national argument	£257,670	General Balances
<b>Return of Seconded Officers</b>	Unexpected returns have significant financial impact as it is usually only possible to offset their return to force by reducing probationer recruitment at the end of the year. There are currently 21 officers seconded, including to nationally and regionally funded initiatives.	£1,000,000	Dorset Police faced a significant unbudgeted cost in 1993 when a national training college closed part way through year	Funding pressures on other forces and organisations may result in return of officers	25%	Worst case - assumes 25% of officers return halfway through year	£250,000	General Balances
<b>Partnership (excl. Road Safe)</b>	May be additional costs if third party funding further reduced. From risk register	£100,000	Could leave Dorset Police with redundancy costs if funding removed, although partnership funding significantly reduced over recent years	Local government partners also under financial pressure and removal of grants increasingly likely	25%	Amount not significant enough to require smoothing. Natural wastage & reallocation of staff should negate redundancies	£25,000	General Balances

<b>Road Safe / DAS</b>	Risk of Dorset Road Safe Partnership scheme being halted, either as a result of Highway's Authorities decisions or as a result of general legislative change. Reduced funding for Road Safe to date has been accommodated within existing budgets. However, there is a clear possibility that this funding position will worsen further in future years. Withdrawal of Road Safe funding also has an adverse effect on Driver Awareness Scheme (DAS) course provision	£500,000	Road Safe Partnership funding is decided annually by the three local authorities. The Dorset scheme issues relatively high numbers of tickets and has a high cost per ticket charge.	Susceptible to legal changes and reduced funding to local authorities	20%	Significant probability of reduced Road Safe funding and income from DAS will primarily be addressed through revenue budget	£100,000	General Balances
<b>Treasury Management</b>	Risk of funds invested in organisations that are not able to repay.	£10,000,000	Probability should be low following a full review of Dorset Police's Treasury Management Strategy	In the current economic climate it is possible for such a scenario, but reviews following the 2008 Icelandic Banking crisis have led to greater safeguards put in place	4%	Low chance of further losses due to strengthening of Treasury Management policy	£400,000	General Balances
<b>TOTAL</b>	<b>Equivalent to 3% of 2013/14 budget.</b>						<b>£3.6m</b>	<b>General Balances</b>