



**Cumbria Shared Internal Audit Service**  
**Internal Audit report for Cumbria Constabulary &**  
**OPCC**  
**Audit of Financial Sustainability**

**Draft Report Issued: 6 April 2022**

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## Audit Resources

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## Audit Report Distribution

For Action:	Roger Marshall (Joint Chief Finance Officer)
For Information:	Rob Carden (Temporary Deputy Chief Constable)
Audit Committee:	The Joint Audit Committee which is due to be held on 22nd June 2022 will receive the report.

*Note: Audit reports should not be circulated wider than the above distribution without the consent of the Audit Manager.*

# Executive Summary

## Background

This report summarises the findings from the audit of **Financial Sustainability**. This was a planned audit assignment which was undertaken in accordance with the 2021/22 Audit Plan.

Financial sustainability is important to both the OPCC and Constabulary because it contributes to the efficient and effective use of resources to support operational policing needs, directly supports the strategic priority of spending money wisely and helps with the delivery of objectives in the Police and Crime Plan for Cumbria 2016-20 and Vision 2025.

Robust financial planning is fundamental to financial sustainability and requires an understanding of demand pressures, long term financial resources and how sustainable it is to deliver priorities and services. This is particularly important at a time when Cumbria Constabulary, and the wider public sector, is facing increasing financial pressures, including the ongoing need to identify and deliver savings.

## Audit Approach

### Audit Objectives and Methodology

Compliance with the mandatory Public Sector Internal Audit Standards requires that internal audit activity evaluates the exposures to risks relating to the organisation's governance, operations and information systems. A risk-based audit approach has been applied which aligns to the five key audit control objectives.

### Audit Scope and Limitations

The Audit Scope was agreed with management prior to the commencement of this audit review. The Client Sponsor for this review was Roger Marshall (Joint Chief Finance Officer). The agreed scope of the audit was to provide assurance over management's arrangements for governance, risk management and internal control in the following areas:

- Identification and consideration of pressures that impact on financial sustainability
- Review of the budget, forecasts and the Medium Term Financial Forecast (MTFF)
- Risk management, scenario planning and financial modelling
- Plans to address savings gap and robustness of service plans.

There were no instances whereby the audit work undertaken was impaired by the availability of information.

## Assurance Opinion

Each audit review is given an assurance opinion, and this provides Joint Audit Committee and Officers with an independent assessment of the overall level of control and potential impact of any identified system weaknesses. There are 4 levels of assurance opinion which may be applied. The definition for each level is explained in **Appendix A**.

From the areas examined and tested as part of this audit review, we consider the current controls operating around Financial Sustainability provide **Reasonable Assurance**.

This opinion recognises the level of controls operating around financial sustainability and notable strengths, as set out below. However, an organisation's financial sustainability can change very quickly and historically we have seen that this can sometimes be due to external factors outside of their control (such as the 2008 financial crash, 2020 coronavirus pandemic or the current situation in Ukraine). Our assessment of 'reasonable assurance' also acknowledges, as does the OPCC and Constabulary in their reports, that there a number of future financial challenges including the potential impact of changes to the Police Funding Formula and the long term sustainability of the capital programme. The OPCC and Constabulary are fully aware of these issues and are working on some areas to address them such as the Productivity and Efficiency Plan - Innovation Programme, which sets out plans to deliver efficiencies and savings required in the Medium Term Financial Forecast. At the time of the audit the plan was being refreshed in light of the updated MTFF with in-year progress against the plan to be included in financial summary reports from December 2021 onwards. In addition, the PCC and Chief Constable are aware of the potential financial risks arising from Local Government Reorganisation (LGR) and the PCC taking on Fire governance. The financial implications of these will be built in to future MTFF if, or when they arise.

Budget monitoring reports are usually prepared for chief officers of both organisations on a monthly basis but the frequency of this lapsed during the early part of 2021/22 due to issues with forecasting and a conscious decision was taken to not produce the October 2021 financial monitoring report so that finance staff could focus on the 2022/23 budget preparation. However, reporting arrangements appear to be back to normal now and meeting minutes demonstrate that the Joint Chief Finance Officer continued to provide regular verbal reports on financial matters and that there was discussion of the budget position and longer term plans.

*Note: as audit work is restricted by the areas identified in the Audit Scope and is primarily sample based, full coverage of the system and complete assurance cannot be given to an audit area.*

## Summary of Audit Findings

### Controls were operating effectively in the following areas:

- Risks around financial sustainability are captured in the strategic risk registers of both organisations and are reviewed on an ongoing basis by management. Risk at this level recognises uncertainty around government funding levels, potential changes to the police funding formula (to be implemented in 2023/24), inflationary pressures, changes to police pension contributions and the impact of national ICT initiatives
- The Medium Term Financial Forecast (MTFF) has been extended to cover a 5 year timeframe, in accordance with CIPFA best practice (previously the MTFF was a 4 year timescale)
- There is clarity around the approach to medium term financial forecasting and how it covers details of underlying assumptions, risks involved, savings required, costings and potential outcomes
- There is good consideration and assessment of the impact of local, regional and national factors affecting the 2022/23 budget and in the medium term to 2026/27
- There is clear identification and consideration of all income streams and their impact on the 2022/23 budget and in the medium term to 2026/27
- The 2022/23 budget includes 3.5% for police officer pay award which should be sufficient, given the Home Office's recommendation for a minimum pay rise of 2% for 2022/23. Currently, the MTFF includes realistic assumptions about future pay awards, a cumulative averaging of 2.19% per annum over the four years after 2022/23
- There are reasonable estimates for non-pay inflation within the MTFF from 2023/24 onwards, with a continuation of the sensible approach of using a higher rate for fuel and energy costs
- There is consideration within the 2022/23 budget of the continued impact of COVID-19 pandemic with the retention of a COVID recovery and renewal budget for 2022/23
- A detailed spreadsheet is in place which provides a way of building up the 2022/23 budget and MTFF and can be used to assess different scenarios using different rates for pay, non-pay, fuel and energy prices inflation, pension contributions, council tax and government grants
- Savings are clearly identified in the Medium-Term Financial Forecast and are to be achieved through a number of Vision 2025 initiatives. There are no unidentified savings in the 2022/23 budget
- There is a separate Reserves Strategy in place

- Finance presentations and reports show an awareness and understanding of current and future demand and the pressures on the service that impact on financial sustainability
- Monthly financial reports have been prepared since July 2021 (excluding October 2021) for chief officers of both organisations
- Quarterly budget monitoring is reported to the ‘Public Accountability Conference’ (with the exception of Q1 in 2021/22) with a summarised version prepared for the Police & Crime Panel
- In response to a recommendation from external audit, from December 2021 the Financial Summary reports to chief officers of both organisations have included details about in year progress on delivery of the savings plan
- The Joint Chief Finance Officer provides verbal updates at Joint Audit Committee (JAC) meetings as to latest financial position and longer-term financial outlook as part of the ‘Corporate Update’ agenda item. This helps JAC members to understand the current and future financial challenges faced by the PCC and Constabulary. Furthermore, a JAC development session took place in March 2022 that included a budget briefing presentation by the Joint Chief Finance Officer and Deputy Chief Finance Officer
- There is a separate Capital Strategy in place that outlines how capital expenditure plans are underpinned by various asset strategies (Digital, Data & Technology Strategy, Estates Strategy and Fleet Strategy) and linked to the Commissioner’s Police and Crime Plan and the Constabulary’s Vision 2025
- A ten-year capital programme is in place with plans about how it is financed but it should be noted that there is a £7.62m funding deficit after 2025/26.

The recommendations arising from this review can be summarised as follows:

High	Medium	Advisory	Total
0	3	0	3

The three levels of audit recommendation are defined in **Appendix A**.

**Areas for development:** Improvements in the following areas are necessary in order to strengthen existing control arrangements:

High Priority Issues:

- None

Medium Priority Issues:

- The 2022/23 budget includes general inflation of 3.5% and at 5% for fuel and energy costs. This was not unreasonable, when preparing the budget, but we are now seeing much greater than expected increases in inflation. The Bank of England expects inflation to rise to around 8% in spring 2022, and perhaps even higher later this year, but to fall back over the next couple of years. The impact of this will need closely monitored. Although, budget scenario planning / sensitivity analysis considered changes of 0.5% to 1% there may be a need, moving forward, to extend the top end of the range used
- The ten year capital programme is now only fully funded for the four-year period to 2025/26 with an overall capital programme funding deficit of £7.62m by 2031/32 despite revenue contributions of over £3.7m per annum in the years 2026/27 to 2031/32. There may need to be further revisions to the capital programme, and it is highly likely that additional revenue savings will need to be found to help fund the longer term capital programme against a background of potential changes to the Home Office police funding formula which may mean further, and potentially more significant, revenue savings need to be found
- Unlike in previous years, the Quarter 3 financial summary, considered at the Public Accountability Conference (PAC) on 16 February 2022, was the first time in 2021/22 that a financial summary was publicly available on the PCC's website for taxpayers to get an overview of the financial position for 2021/22.

Advisory Issues:

- None.

## Temporary Deputy Chief Constable Comments

I recognise that financial sustainability is critical to the successful long-term operation of the Constabulary and welcome the overall assessment that there are robust financial planning and management processes in place. The recent emergence of inflationary pressures in the world economy will undoubtedly filter through to all public sector organisations. The Constabulary is fully cognisant of the challenges this will present and will be providing enhanced scrutiny of the financial impact through the monthly budget monitoring process. We will also actively explore opportunities to identify savings to offset the effect of increased inflation in 2022/23. Over the medium term, I, alongside the newly appointed Assistant Chief Officer, will personally assume responsibility for ensuring that savings plans and the capital programme are actively developed and managed to ensure financial sustainability. The Constabulary and PCC remain committed to transparency in the reporting of their financial position.

Rob Carden  
T/Deputy Chief Constable

# Management Action Plan

## Medium Priority

Audit finding	Management response
<p><b>Estimates and scenario planning</b></p> <p>The PCC's and Constabulary's overall approach to estimates and scenario planning is sound and has been for many years. This has included:</p> <ul style="list-style-type: none"> <li>• Providing for annual pay awards over the lifetime of the MTFF</li> <li>• Providing for general inflation over the lifetime of the MTFF and using a higher rate for fuel and energy costs</li> <li>• Scenario planning on the 2022/23 budget and MTFF for some of the key assumptions (pay inflation, general inflation, fuel inflation, police pensions, local government pensions, council tax precept &amp; council tax base and government grant) by assessing the impact of a change of 0.5% and 1%</li> </ul> <p>In previous years changes in inflation, and particularly energy and fuel inflation, will not have been significantly outside of the ranges used in the budget and MTFF. However, there are a number of external factors that are impacting on general inflation and particularly on fuel and energy inflation.</p> <p>For the 2022/23 budget general inflation has been set at 3.5% and at 5% for fuel and energy costs. This was not unreasonable, when preparing the budget, but we are now seeing greater than expected increases in inflation.</p> <p>The Office of National Statistics (ONS) reported on 23 March 2022 that 'The Consumer Prices Index (CPI) rose by 6.2% in the 12 months to February 2022, up from 5.5% to January 2022. This is the highest CPI 12-month inflation rate in the National Statistic series</p>	<p><b>Agreed management action:</b></p> <p>Senior management and the finance team are very alive to the potential impact of inflation on the budget position.</p> <p>Whilst this is unlikely to be fully adequate volatile budgets such as energy, fuel and insurance are re-based each year. For example the electricity budget was increased by 23% in 2022/23.</p> <p>In the context of the current inflationary pressures a report on the potential impact of inflation in 2022/23 was submitted to the Chief Officer Group on the 3<sup>rd</sup> April. Current indications are that whilst there are likely to be overspends on some budget lines as a result of inflation these are considered manageable in the short term. The effect of inflationary pressures will continue to be closely monitored through the normal monthly management accounts process through the year.</p> <p>Exceptional reports may also be produced if the situation warrants it. We will also examine</p>

<p>which began in January 1997, and the highest rate in the historic modelled series since March 1992, when it stood at 7.1%'. Added to this the Bank of England reported on 18 March 2022 that 'We expect inflation to rise to around 8% in spring 2022 and perhaps even higher later this year. We expect it to fall back over the next couple of years'. The specific rates of increases in fuel and energy are likely to be even higher.</p> <p>Given these larger than expected increases there will be a need to closely monitor inflation rates and assess their additional impact, beyond that already included in the 2022/23 budget. Although the Bank of England has suggested that inflation will fall back over the next couple of years it would make sense to also consider 2023/24. In addition, given that scenario planning / sensitivity analysis has already looked at changes of 0.5% to 1% there may be a need, moving forward, to extend the top end of the range used to 2% to 5%.</p>	<p>the best way to communicate the effects of inflation, which may include extending the range of scenario planning. The latest report includes a scalable analysis which allows the effect of a variety of inflation scenarios to be modelled.</p>
<p><b>Recommendation 1:</b></p> <p>Management should closely monitor inflation rates and assess their additional impact, beyond that already included in the 2022/23 and 2023/24 budgets. Given the current rates of inflation management should consider extending to extend the top end of the range used to 2% to 5%.</p>	
<p><b>Risk exposure if not addressed:</b></p> <ul style="list-style-type: none"> <li>• Insufficient provision made for inflation in annual budget and MTF.</li> <li>• Unexpected savings need to be delivered in current and future years.</li> </ul>	<p><b>Responsible manager for implementing:</b> Roger Marshall Joint CFO</p> <p><b>Date to be implemented:</b> 30/06/2022</p>

Medium Priority

Audit finding	Management response
<p><b>Capital Programme</b></p> <p>There is a separate ‘Capital Strategy’ in place which outlines how capital expenditure plans are underpinned by various asset strategies, which are linked to the Commissioner’s Police and Crime Plan and the Constabulary’s Vision 2025. There is a more detailed capital programme covering the next 10 years. Significant capital expenditure is planned for 2023/24 (£12.28m) and 2024/25 (£12.23m) on infrastructure replacement projects and planned replacement of the Territorial Policing HQ in West Cumbria at the end of the PFI Contract.</p> <p>Since the last capital programme was agreed in February 2021 there has been an increased number of new capital demands at a cost of around £4.9m plus increased costs for ESN (£3m) and Fleet (£3m). The impact of this is that the capital programme is now only fully funded for the four-year period to 2025/26. In years 5-10 of the programme there are some shortfalls with an overall capital programme funding deficit of £7.62m by 2031/32 despite revenue contributions of over £3.7m per annum in the years 2026/27 to 2031/32.</p> <p>By the end of 2023/24 historic capital grant and general capital reserves will have been fully utilised. This, in combination with the removal of capital grant from 2022/23, means that the capital programme becomes even more reliant on revenue contributions to support capital expenditure. There is a real risk that after 2025/26 the capital programme will no longer meet the ‘affordability, prudence and sustainability’ tests set out in the Prudential Code. This can only be addressed by reducing capital expenditure or further revenue contributions (£0.76m per annum over 10 years or £1.27m per annum over years 5-10). Most worrying is the £2.9m deficit in 2026/27 largely as a result of the increased cost of the Emergency Services Network (ESN) commonly known as ‘Airwave’.</p>	<p><b>Agreed management action:</b></p> <p>The Joint Chief Finance Officer has highlighted both to the Constabulary and PCC the need to ensure that savings are delivered to put both the revenue and capital budgets are put on a sustainable basis.</p> <p>The Chief Constable has instigated a Gold Group, part of whose remit is to develop a savings plan to address the medium term savings gap.</p> <p>In the current volatile financial situation both the MTFE and savings plans will be regularly updated to ensure that senior management are aware of the latest position.</p> <p>In relation to funding the capital programme, annual revenue support for the programme has been tripled in recent years and potential need to increase this further will be highlighted as part of budget planning options.</p>

<p>There may need to be further revisions to the capital programme, and it is highly likely that additional revenue savings will need to be found to help fund the longer term capital programme. There is also the potential that the Home Office review of the police funding formula could be implemented in 2023/24 and this may well mean further, and potentially more significant, revenue savings need to be found. Therefore, when considering the capital programme, and the options to address its longer term sustainability, there is a need to ensure that all potential factors are considered.</p>	
<p><b>Recommendation 2:</b> Ensure that when considering options to address the longer term sustainability of the capital programme that all potential factors are considered e.g. likely impact of the review of the police funding formula (scheduled for implementation by 2023/24).</p>	
<p><b>Risk exposure if not addressed:</b></p> <ul style="list-style-type: none"> <li>• Unsustainable capital programme which could impact on the ability of the PCC and Chief Constable to deliver strategic objectives</li> <li>• Additional / unexpected revenue savings need to be delivered in future years.</li> </ul>	<p><b>Responsible manager for implementing:</b> Roger Marshall Joint CFO <b>Date to be implemented:</b> 31/12/2022</p>

## Medium Priority

Audit finding	Management response
<p><b>Availability of financial summary reports provided at Public Accountability Conference (PAC)</b></p> <p>Management accounts for June 2021 (Q1) were not produced due to problems with forecasting and the first financial reports produced for 2021/22 were to 31 July 2021, and these went to Chief Officer Group (COG) and the Police and Crime Panel. However, there was no finance Public Accountability Conference (PAC) meeting held at the time that could have received a Quarter 1 report (had it been produced) or the report to 31 July 2021 so the financial information for the early part of 2021/22 was not provided publicly.</p> <p>The Quarter 2 financial summary was considered at the PAC on 3 November 2021 however, unlike previous meetings, the supporting reports were not attached to the agenda (for any of the agenda items) on the Police and Crime Commissioner's (PCC's) website. However, we were informed by management that it was published on the PCC's website under the Finance and Governance section.</p> <p>The Quarter 3 financial summary was considered at the PAC on 16 February 2022 and this time supporting reports were attached to the agenda on the PCC's website. The impact of this is that it was not until the meeting on 16 February 2022 that a summary was publicly available on the PAC agendas and papers for taxpayers to get an overview of the financial position for 2021/22.</p> <p>Publicly available quarterly financial summary reports are a key feature of Public Accountability Conference meetings and a way for the PCC to demonstrate, in a transparent way, his holding the Chief Constable to account for the Constabulary's financial performance. In addition, as the PCC's financial position is also reported it gives the taxpayer a good overview of the PCC's financial performance as well as that of the</p>	<p><b>Agreed management action:</b></p> <p>The quarter 2 and quarter 3 financial position has been published on the PCC Website with the quarter 2 position shown published under the finance and governance section of the website from early November when it was presented to the PCC Public Accountability Conference.</p> <p>It is acknowledged that quarter 1 monitoring was not published. This was due to a combination of a delay in collating the data until July due to the new financial system being bedded in and the reduced number of PAC meetings, but this was very much the exception.</p> <p>Going forward we will publish quarterly financial monitoring data irrespective of whether it is presented to PAC and will ensure that there is a link from PAC meetings to the papers on the website.</p>

<p>Chief Constable. For financial information to be of most value to the reader it needs to be timely and therefore there is a need to ensure that financial summary reports to PAC are produced on a quarterly basis and are always attached to the agendas to support the transparency agenda.</p>	
<p><b>Recommendation 3:</b> Ensure that the financial summary reports that go to Public Accountability Conference (PAC) are produced on a quarterly basis and are always attached to the agendas so that taxpayers are able to get an overview of the overall financial position.</p>	
<p><b>Risk exposure if not addressed:</b></p> <ul style="list-style-type: none"> <li>• Lack of transparency about the in-year financial position of the PCC and Chief Constable</li> <li>• Inability of the local taxpayer to assess the overall PCC / Chief Constable financial position making it difficult for them to have an informed view to provide a response to the next year's budget consultation.</li> </ul>	<p><b>Responsible manager for implementing:</b> Roger Marshall JCFO &amp; Gill Shearer Chief Executive</p> <p><b>Date to be implemented:</b> 30/06/2022</p>

## Appendix A

### Audit Assurance Opinions

There are four levels of assurance used, these are defined as follows:

Assurance Level	Definition
<b>Substantial</b>	Sound frameworks of governance, risk management and internal control are in place and are operating effectively. Recommendations, if any, will typically be no greater than advisory.
<b>Reasonable</b>	Frameworks of governance, risk management and internal control are generally sound with some opportunities to further develop the frameworks or compliance with them. Recommendations will typically be no greater than medium priority.
<b>Partial</b>	Weaknesses in the frameworks of governance, risk management and/or internal control have been identified or there are areas of non-compliance with the established control framework which place the achievement of system / service objectives at risk. Recommendations will typically include high and medium priority issues.
<b>Limited</b>	There are significant gaps in the governance, risk management and/or internal control frameworks or there are major lapses in compliance with the control framework that place the achievement of system / service objectives at significant risk. Recommendations will include high priority issues.

### Grading of Audit Recommendations

Audit recommendations are graded in terms of their priority and risk exposure if the issue identified was to remain unaddressed. There are three levels of audit recommendations used; high, medium and advisory, the definitions of which are explained below:

Grading	Definition
<b>High</b>	A recommendation to address a significant gap in governance, risk management or internal control frameworks or to address significant non-compliance with controls in place.
<b>Medium</b>	A recommendation to address a gap in governance, risk management or internal control frameworks or to address aspects of non-compliance with controls in place.
<b>Advisory</b>	A recommendation to further strengthen governance, risk management or internal control frameworks or to improve compliance with existing controls.

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