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11 March 2016

Sir Mike Pitt
 Chairman
 Legal Services Board
 One Kemble Street
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By email

Dear Mike,

Further to your letter of 3 February and our meeting of 9 February, I have pleasure in submitting the Office for Legal Complaints Annual Budget for 2016/17. You will be aware that our Chief Executives met on Monday 7 March to ensure that we have clarity over the information being presented and what is required for your Board meeting on 23 March.

The headline figure is that we are seeking a total budget of £13.63m for FY 2016/17. This is a reduction of £1.21m on FY 2015/16 which is a reduction of 8.1%.

In your letter you set out the criteria your Board needed to see addressed. These are set out below with references to the appropriate section of our budget.

- *in accordance with the Act, an indication of **the distribution of resources** deployed in the operation of the ombudsman scheme and **the amounts of income** OLC expect to arise from the operation of the scheme. This should include a clear breakdown of:

 - *staff costs and numbers broken down by function – for instance: enquiries; investigations; ombudsman team; corporate, others*
 - *any possible variation around the income prediction eg in response to volume changes, or should changes to the case fee structure be introduced in-year**

The distribution of resources is set out at the start of Section 4 for the Legal complaints budget, Section 5 for the CMC complaints budget, and Section 6 for the Indirect costs budget

- *a summary of the **key risks** to delivering the Plan for 2016/17 **and mitigation** proposed*

The key risks and mitigating actions are set out in Section 8. Section 8.1.1 deals specifically with variations from planned contact and case volumes.

- *the **volumes predicted** for the year, along with a **sensitivity analysis** illustrating the organisation's response should volumes fluctuate. In particular,

 - *what is the resourcing strategy for responding to in-year fluctuations (up or down) particularly in the climate of recruitment and spend controls*
 - *if activity to address the question of numbers of contacts that turn into cases results in a change to volumes, what would be the resourcing strategy response**

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The volumes for Legal complaints are set out at Section 4.1.1 and for CMC complaints at Section 5.1.1. The sensitivity analysis is set out at Section 7 with the resourcing strategy for responding to in-year fluctuations at Appendix 1.

*a summary of where the budget has changed in response to **stakeholder responses** to consultation. I should emphasise that the Board will expect to see the **outcome of discussions with MoJ** and the extent to which the final budget takes account of their input covered explicitly before it reaches a decision.*

Our Budget has not changed as a result of stakeholder responses to consultation.

Like the LSB we have been required to respond to a commission from the Ministry of Justice setting out how we intend to manage our establishment over the Comprehensive Spending Review period from 2015-2020. We have set out our approach to reducing front-line posts by 15% (in value) and non front-line posts by 50%, over the period, indicating early savings in FY 2016/17. Informal indications are that our submission has been favourably received, and the link to my recent meeting with their senior NED, Sir Theodore Agnew, has been noted.

the OLC Board's most up to date thinking on the extent to which the budget is designed to deliver transformational change eg around the operating model to allow for a more flexible response to demand change. In particular, what elements within the budget are intended to deliver system improvements ie 'one off' costs and what could more reasonably be considered 'steady state'

Having, hopefully, now completed the resolution of the issues which arose from the previously qualified accounts, the OLC's aspirations for 2016/7 are focussed upon sustainable consolidation rather than any further attempts at 'transformational change'. This approach does not require significant 'one off' budgetary provision. The Board is aware that there are efficiencies to be gained from developing a more flexible staffing model, exploiting the new IT system and adopting best practice, as developed in either of the jurisdictions. These initiatives will all be included in the Legal Ombudsman business plan and will assist in meeting the MoJ's spending expectations.

I look forward to attending your Board meeting on 23 March 2016.

Yours sincerely,



Steve Green
Chair
Office for Legal Complaints

Atts:

Office for Legal Complaints

Budget 2016-17

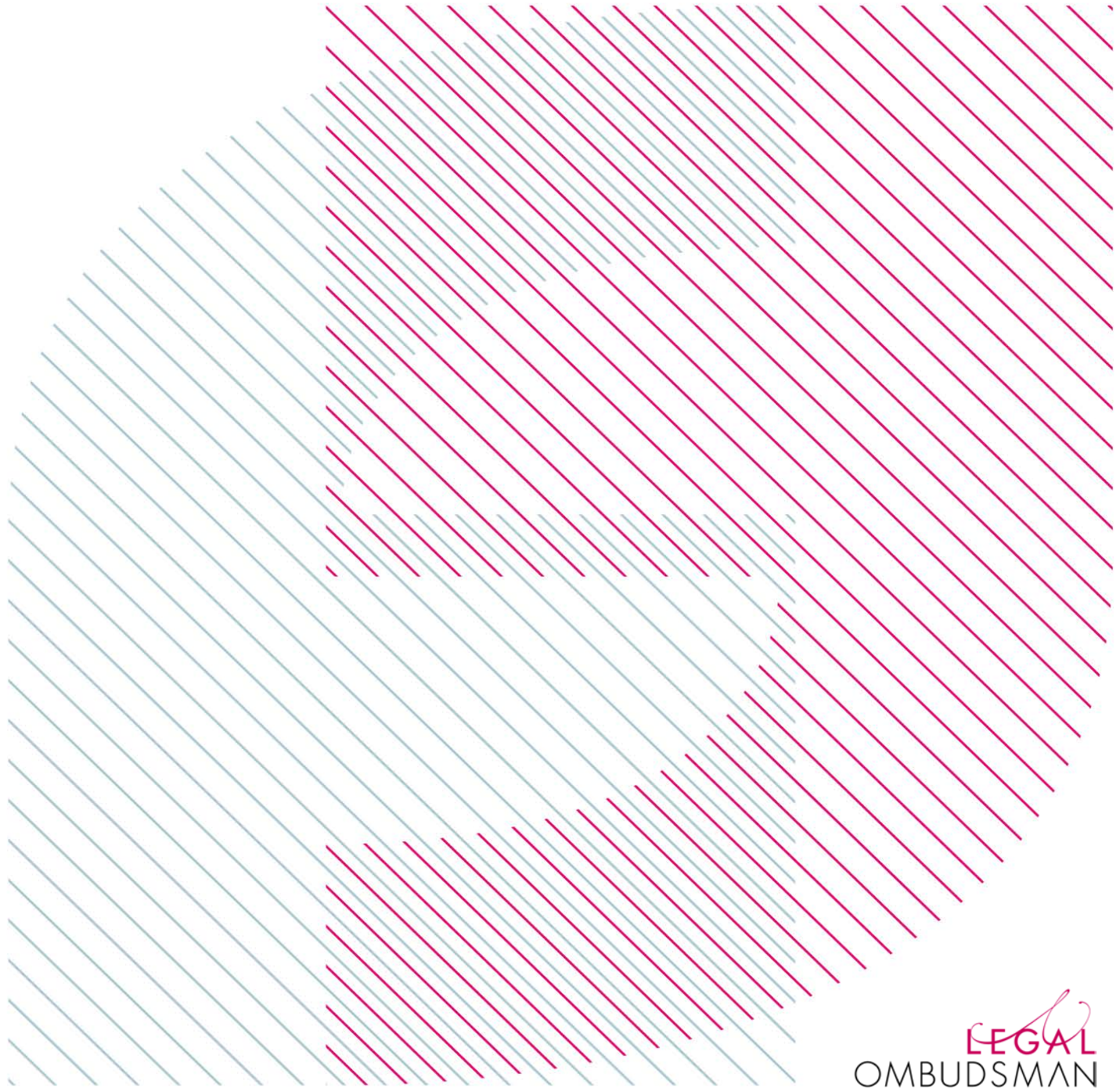


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1 Executive Summary

The budget for 2016/17 will be the first budget prepared after 12 months of dealing with the Claims Management Company (“CMC”) complaints handling activities, providing a better understanding of its running costs. The budget has again been included within the OLC’s overall income and expenditure. The funding of complaint handling for the legal profession (“Legal activities”) and complaint handling for the claims management industry (“CMC activities”) are separate.

The OLC recognises the requirement to and shall maintain and account for the expenditure relating to Legal activities and CMC activities separately. This separation has been reflected in the proposed budget, which clearly identifies separate budgets for Legal activities and CMC activities within the overall OLC budget as well as separately budgeting for those Indirect costs to be apportioned between the Legal and CLC jurisdictions in line with the basis agreed between the OLC, LSB and MoJ.

Following a year of change the OLC intends 2016-17 to be a year of stability and consolidation, with a Board that has a year of working together and a new Chief Executive and Chief Ombudsmen established in their posts. The following activities have and will continue to help this process:

- The regularisation of various allowances which the Principal Accounting Officer of the Ministry of Justice had determined to be novel and contentious. This has resulted in a reduction in staff costs.
- Implementing an action plan following a comprehensive external review of all key financial processes and controls throughout the organisation in order to confirm and to provide the PAO with assurance that no issues exist other than those identified in the 2013-14 accounts. Whilst this will require a small number of additional posts which will add to indirect costs, these posts have been authorised by the MoJ.

Nonetheless the OLC is not immune from change and uncertainty and the following issues which could impact on our finances will be kept under review:

- Case volumes in both the legal and CMC jurisdictions. We are planning on similar volumes for 16/17 as experienced in 15/16
- Our ability to recover case fees, as well as reviewing the level of case fees
- The need to reduce overall public sector expenditure and the need for OLC to play its’ part. OLC will continue to review all expenditure with the intention of achieving savings over the Comprehensive Spending Review period, in consultation with the MoJ and Legal Services Board.

The level of uncertainty around the expenditure that will result from these activities is less than in previous years. Nonetheless it is still prudent to include an element of contingency in the 2016/17 budget, appropriately distributed where necessary between Legal activities, CMC activities and Indirect costs.

Since the publication of the consultation document, we have sought to reduce the costs incurred on a shared basis that would then need to be apportioned between the Legal and CMC jurisdiction as indirect costs. We will continue to refine this as the CMC jurisdiction develops. This is reflected in our proposed budget.

The MoJ has been consulted on the proposed budget for CMCs and has been asked to confirm its position regarding the CMC element of this budget to the Legal Services Board.

Schedule 15 section 23 (1) of the Legal Services Act requires the OLC, before the start of each financial year, to adopt an annual budget which has been approved by the Legal Services Board. The OLC has approved the proposed budget and respectfully recommends its approval by the Legal Services Board.

2 Forecast out-turn for 2015/16

2015/16 Out-turn

Legal Jurisdiction	2011/12 Actual	2012/13 Actual	2013/14 Actual	2014/15 Actual	2015/16 Out-turn
Cases Investigated	8,420	8,430	8,323	7,635	6,850
Cost of the Ombudsman scheme	£17.0m	£16.5m	£15.7m	£12.8m	£11.8m
Unit cost £	£2,019	£1,957	£1,886	£1,676	£1,722

In July 2013 OLC and LeO executive management set out an ambition and implemented a plan to reduce expenditure from £16.5 million in 2012-13 in order to achieve a budget of around £12.0m by 2015/16. Over the last 24 months the OLC and LeO's management team have delivered the planned benefits of this cost reduction plan. The 2015/16 forecast also includes an amount for the regularisation of the FBS (flexible benefits scheme), deemed a contentious and novel remuneration item. The focus on efficiency will continue into 2016/17 and the budget reflects this direction.

The CMC jurisdiction outturn expenditure is forecast at £2.2m, including £0.8m allocated from LeO's fixed overhead. This is in line with the 2015/16 live operating budget agreed with the MoJ

Proposed focus for 2016/17

Our strategic plan consultation document proposed that we continue with the following four goals which are:

- To continue to improve our efficiency
- To implement agreed changes to our jurisdiction
- To help create an improved legal complaints handling system
- To disseminate what we have learned more widely

3 Proposed budget

The proposed budget for 2016/17 is set out as follows, appropriately split between Legal Activities and Claims Management activities. These budgets are set out in more detail in Section 4 (Legal Activities) and Section 5 (Claims Mgt Activities) together with the current forecast comparatives for 2015/16:

	Legal Activities £'m	Claims Mgt Activities £'m	OLC Budget £'m
Levy income / Grant in Aid	10.61	1.76	12.37
Case Fee income	0.94	0.32	1.26
Total Income / funding	11.55	2.08	13.63
Direct Costs			
Staff	6.25	1.11	7.36
Other services	0.41	0.18	0.59
Unrecoverable case fees	0.12	0.11	0.23
Total Direct Costs	6.78	1.40	8.18
Total Indirect cost	4.77	0.68	5.45
Total expenditure	11.55	2.08	13.63
Planned cases investigated	7,000	2,000	
Capital expenditure			0.46

	Legal Activities	Claims Mgt Activities	Indirect	Total
FTE Headcount 2016/17**	164.1	26.5	47.6	238.2
FTE headcount 2015/16*	153.1	21.5	45.5	220.1

* - Forecast year end position

** - Average

NB average headcount 2015/16 was 250.0

4 Legal complaints budget

		2015/16 Forecast £'000	2016/17 Budget £'000
Levy Income	4.1.3	10,899	10,605
Case Fee Income		913	940
Total Income		11,812	11,545
Staff Costs	4.1.4	6,444	6,251
Recruitment	4.1.4	17	20
Training	4.1.4	27	30
Travel & Subsistence		3	5
Printing, postage and scanning	4.1.5	177	184
Translation services	4.1.6	42	42
Research/ coms / marketing	4.1.7	<u>22</u>	<u>130</u>
Other services - subtotal		288	411
Unrecoverable case fees	4.1.8	151	120
Indirect cost allocation	6.1	4,929	4,763
Total Revenue Expenditure		11,812	11,545
Anticipated volume	4.1.1	6,850	7,000

Operational Headcount	2015/16 FTE *	2016/17 FTE ave**
Operations Management & Team Leaders	15.7	16.7
Ombudsmen	15.0	13.6
Investigators	88.3	94.5
Assessors	26.5	32.3
Coordinators	7.6	7.0
	<u>153.1</u>	<u>164.1</u>

* - Forecast year end position

** - includes assumptions for leavers throughout the year

NB see note on section 3 re average headcount 2015/16

4.1 Legal complaints – key assumptions

4.1.1 Legal activity volumes and expected demand for complaint handling

The key demand measures for the organisation are set out below:

	Actual 2011/12 Activity	Actual 2012/13 Activity	Actual 2013/14 Activity	Actual 2014/15 Activity	Forecast 2015/16 Activity	Budget 2016/17 Activity
Number of Cases investigated	8,420	8,430	8,323	7,635	6,850	7,000
Cases resolved (external measure)	7,455	7,500	8,055	7,371	6,620	6,700

January to March 2016 forecast activity has been increased as the result of the staffing reallocations in order to deal with work delays at key points. The clearing of the WIP is key to achieving a better service all round. Key efficiencies due to improvements through the Case Management System have yet to realise. We anticipate that these volumes will continue in the coming months and into 2016-17.

Q4 of 2015 was very closely matched to Q4 of 2014. However Q1, Q2 and Q3 of 2015 were substantially down on cases seen in previous years. Despite our predictions last year for a continued increase in conveyancing complaints, residential complaints were closer to 2012 levels. Conveyancing transactions last year were around 20,000 higher in England and Wales than in 2012, therefore reduced transactions cannot account for this reduction in complaint levels. Residential conveyancing still equates to just over 20% of our legal service complaints. Changes to the conveyancing market over the next year include a 3% stamp duty land tax surcharge for buy-to-let landlords and people with second homes, and this is expected to hit the market when it comes into effect in April. The conveyancer sentiment tracker, run by search provider SearchFlow, shows that 27% of conveyancers believe transaction levels will increase by up to 20% this year. Given the future increasing market and yet current reduction of transactions, we are budgeting to remain fairly static in this area.

Wills and probate, whilst lower in Q1 have seen a return to comparable 2014 figures, less change is expected in this market sector however costs of probate are due to increase this year the impact on this on transactions is minimal. The work of the Competition and Markets Authority around Will Writing may have an impact on the regulation of this area in coming years, however will offer no impact this year.

We anticipate that a stable projection of complaints in Family Law, Crime and Employment areas of law will continue. Other areas of law had declined across the first three quarters of 2015 before a comparable quarter 4 and figures are closer aligned to 2012 figures. We would expect a stable level of complaints continuing in 2016.

Allowing for between 6% and 7% of cases accepted to be outside of our jurisdiction (our current experience), we plan to accept around 7,000, and to resolve around 6,700 in 2016/17 which includes and anticipates ongoing reductions in work in progress.

4.1.2 Legal Activity: Investigator efficiency

In resourcing the organisation we recognise that some investigators are asked to undertake secondments or other development work from time to time. We use a metric that excludes this “non investigation time”, together with periods of new starter’s initial training and long term sickness or absence, to determine a metric for the “active” investigators (those who are actively engaged in case-work). The case management system did not deliver on the expected efficiencies in 2015/16 and therefore the investigator efficiency remains at 7.6 per active investigator per month in 2015/16.

We anticipate that further productivity gains will be realised from the case management system but this continues in its development currently and so gains will not be realised until later in 2016/17.

4.1.3 Levy & Fee Income

Our income in respect of Legal activities is made up of two streams;

- The Levy – which is equal to the expenditure incurred by the Legal Ombudsman in delivering the Ombudsman scheme, less Case fees charged.
- Case Fee Income –Our scheme rules require us to charge a case fee for every potentially chargeable case where it has been decided not to waive the fee. We intend to review our fee structure in Q1 2016-17.

4.1.4 Staff costs, recruitment and training

Direct recruitment and external training costs are expected to be broadly similar to those experienced in 2015/16.

4.1.5 Printing, postage and scanning

Our business processes and case management systems are designed to minimise the use of paper at our premises. All case documents are scanned remotely and uploaded into our case management system. All case-work documents produced are printed remotely and posted to complainants. Arrangements have been made with suppliers to ensure that they differentiate between legal activity and CMC activity and hence these costs are to be accounted for as direct costs and not apportioned.

4.1.6 Translation services

This reflects the costs of the translation of correspondence with complainants into appropriate languages in order to ensure that our service is accessible to all. Arrangements have been made with suppliers to ensure that they differentiate between legal activity and CMC activity and hence these costs will be accounted for as direct costs and not apportioned.

4.1.7 External research, insight and analysis

In order to help create an improved complaint handling across the legal sector, better inform consumers of these services and to help inform the profession and regulatory bodies, we are building up our in-house capability to research, analyse and disseminate the data generated by our work. This internal focus means that we have reduced our direct external research budget to £130k for the coming financial year.

Because this area of work is still being developed, the funding has not been allocated to specific research or analysis activities. The OLC is also open to working with the regulator community to collaborate on these activities where there is mutual interest. The OLC Board and management will not commit this expenditure until clear outcomes have been defined and approved but it is essential that steps are taken now to ensure that adequate budget resource is allocated to this area.

4.1.8 Unrecoverable cases fees

We have historically experienced a significant proportion of unrecoverable case fees. The bad debt expense budgeted for in 2016/17 reflects reduced bad debt experience during 2015/16 to date compared to previous years. Bad debts mainly arise where the law firm has gone out of business during an investigation or by the time the complaint is brought to us or by the time it has been resolved. Over the last year we have experienced reduced frequency where this is the case and hence a reduction in bad debt costs. Improved debt collection practices both in-house and using money collection services are also continuing to contribute to the reduction. We have included a reserve for bad debts of £120k for 2016/17, lower than our expected experience in 2015/16.

5 CMC complaints budget

		2015/16*	2016/17
	Section	Forecast	Budget
		£'000	£'000
Case Fee Income	5.1.3	391	320
Total Income		391	320
Staff Costs	5.1.4	1,011	1,109
Recruitment	5.1.4	0	10
Training	5.1.4	2	10
Direct Travel & Subsistence		1	5
Printing, postage and scanning	5.1.5	22	62
Live Chat service	5.1.6	3	20
Legal fees			10
Research, Surveys, Comms	5.1.7	<u>42</u>	<u>61</u>
Other Services Subtotal		70	178
Unrecoverable case fees	5.1.8	280	112
Indirect cost allocation	6.1	810	680
Total Expenditure		2,171	2,079
Forecast / Budget GIA requirement		1,780	1,759
Business case		£'000	£'000
Expenditure		2,171	2,079
(Excess) / shortfall prior year		(74)	
Case Fees		(391)	(320)
Business case GIA requirement		1,706	1,759

Operational Headcount	2015/16	2016/17
	Forecast	Budget
	FTE*	FTE
		Average
Operations Management & Team Leaders	3	3
Ombudsmen	1	1
Level 1 Investigators	11.7	12.7
Level 2 Investigators	4.8	8.8
Officer	1	1
	<u>21.5</u>	<u>26.5</u>

Note: * = Forecast year end position (lower than average for the year)

5.1 CMC Complaints – key assumptions

5.1.1 CMC activity volumes and expected demand for complaint handling

The business case approved by the MoJ as part of the implementation of the new jurisdiction was based on the mid-point out of the possible volume range of c 12,000 - 15,000 contacts and 3,000 cases per annum. The Actual numbers for the year 2015/16 are forecast to be 18,300 contacts and 2,300 cases accepted.

	Forecast 2015/16 Activity	Budget 2016/17 Activity
Number of Contacts	18,300	17,500
Number of Cases accepted	2,300	2,000

In examining the external market data for last year, we are able to see a downward trend in the number of CMCs authorised and an increase in turnover in the CMC market; however, the number of transactions undertaken is not recorded which would be an indication of the number of customer interactions with CMCs.

We also have to take into consideration that, with a consolidation in the market, a CMC may be determined to be a successor firm to another CMC. As such, the fact that a CMC has now left the market does not affect either the customers' right to complain about them, or our ability to investigate those complaints. We factored this into our planning and predictions.

The Financial Conduct Authority have consulted on implementing a time bar for raising PPI complaints. Once this change has been announced, this may increase our volumes in this area for a short period, due to more companies seeking to action outstanding PPI complaints before the deadline. Our volumes in this area would then likely decrease after the deadline date.

The Claims Management Regulator released a consultation on 15 February 2016 proposing cost reductions for Claims Management Companies (CMCs) in the financial claims sector specifically. The outcome of this consultation could impact the types of complaints that we receive, due to the change in fees that CMCs can charge, and it may also see the CMC market reduce.

In addition in July 2015 it was announced that there would be a fundamental review of the regulation of CMCs. This review will be outlined in early 2016. It is unclear what potential changes may be made and how this will impact the Legal Ombudsman or the CMC landscape.

5.1.2 CMC Activity: Investigator efficiency

During detailed planning for the implementation of the CMC unit, the assumptions and organisational structures were considered and refined. As a result, the mix and roles required were altered, assumptions regarding case complexity and planned headcount were reduced while the skills and competence required of CMC investigators and expected investigator efficiency were increased. The result of this review was that instead of having a separate contact centre and assessment stage, two grades of

investigator have been employed to deal with cases. Level 1 Investigators will deal with simpler cases while Level 2 investigators (equivalent to Legal jurisdiction investigators) will deal with the more complex cases.

Investigator efficiency is running at an average of 20 cases per month, with senior investigators holding an average of 15 due to other commitments.

5.1.3 Income

CMC expenditure is recovered through two mechanisms;

- Grant in Aid – which will be drawn down from the MoJ to the extent of expenditure incurred by the OLC in delivering the CMC element of its scheme, less Case fees charged to CMC firms.
- Case Fee Income – The Scheme rules require us to charge a case fee for every potentially chargeable case where it has been decided not to waive the fee. The scheme rules also establish when a fee will be waived. While the application of these scheme rules requires the exercise of judgement, the scheme rules do not currently allow discretion in respect of when case fees are charged and when case fees will be waived.

5.1.4 Staff costs, recruitment and training

Staff Costs are budgeted based on anticipated headcounts outlined above.

Training. This is in addition to generic training that would be provided to all LeO staff and which is included within the indirect cost allocation. Budget was in place for 2015/16 but remained unused

Direct recruitment costs remain at a minimal value. Wherever possible recruitment is sourced directly without incurring charges

5.1.5 Printing, postage and scanning

Our business process and case management systems are designed to minimise the use of paper at our premises. All case documents are scanned remotely and uploaded into our case management system. All case-work documents produced are printed remotely and posted to complainants. Arrangements have been made with suppliers to ensure that they differentiate between legal activity and CMC activity and hence these costs will be accounted for as direct costs and not apportioned. Costs budgeted have been estimated based on expected case volumes using 2015-16 actuals as a baseline.

5.1.6 Live Chat Service

Online live chat service costs remain static for the year. Numbers appear different in the above budget presentation due to a change in accounting treatment only.

5.1.7 External research, insight and analysis

In order to help create an improved complaints handling system within the CMC industry and to continue to engage with the CMC industry to inform them good complaints handling, LeO will build upon developments it has introduced in the last year. These include activities such as professional learning courses and closer relationship management to help feedback issues and common themes to the industry. As a result

we have reduced our direct budget to £61k for the coming financial year. The OLC Board and management will not commit this expenditure until clear outcomes have been defined and approved, however we believe that, as with our legal activities, it is key to ensure that adequate budget resource is allocated to this area.

5.1.8 Unrecoverable case fees

We have experienced a significant proportion of unrecoverable case fees in our CMC jurisdiction. Bad debt mainly arises where the firm has gone out of business by the time the complaint is brought to us or by the time it has been resolved. This has been a particular area of concern in 2015/16 with the collapse of a major firm in the sector leading to both an increase in case fees issued and immediately being classified as unrecoverable. We believe that the impact of this firm will not continue into 2016/17. We have included a reserve for bad debts of 35% of case fees amounting to £112k for 2015/16.

6 Indirect cost budget

6.1 Indirect costs summary.

		2015/16*	2016/17**	Staff costs 2015/16 £'000	Staff costs 2016/17 £'000	Other costs 2015/16 £'000	Other costs 2016/17 £'000	Total 2015/16 £'000	Total 2016/17 £'000
Chief Exec	6.1.2	4.0	5.8	473	502	18	6	491	508
HR	6.1.3	2.7	3.8	204	200	90	105	294	305
IT and telecoms	6.1.4	12.8	13.0	691	725	1,152	1,034	1,843	1,759
Finance	6.1.5	5.0	6.0	324	240	44	55	368	295
General Counsel	6.1.6	5.0	5.0	315	281	75	49	390	330
Operational Insight & Engagement	6.1.7	14.0	12.0	817	594	20	11	837	605
Research, Comms & Marketing	6.1.8	-	-	-	-	145	179	145	179
Premises and facilities	6.1.9	2.0	2.0	47	47	614	629	661	676
Training, learning & development	6.1.10	-	-	-	-	14	72	14	72
Recruitment	6.1.11	-	-	-	-	191	100	191	100
Travel & Subsistence	6.1.12	-	-	-	-	15	24	15	24
Governance		-	-	-	-	110	150	110	150
Depreciation and impairment	6.1.13	-	-	-	-	380	440	380	440
Total Indirect Headcount & Costs		45.5	47.6	2,871	2,589	2,868	2,854	5,739	5,443
								(4,929)	(4,763)
								(810)	(680)

* - Forecast year end position

** - Average FTE over the 12 months to 31 March 2017

6.1.1 Basis of apportionment of indirect costs

Indirect costs comprise those resources which benefit and support both Legal and CMC activities. These costs are to be apportioned to CMC Activities (and hence to the MoJ) and to Legal activities (and Approved regulators) in proportion to the numbers of Operational employees dedicated to the CMC activities and Legal activities respectively.

This basis of apportionment of costs has been agreed by the OLC, LSB and MoJ and is intended to result in a fair and proportionate allocation of costs between CMC and Legal jurisdictions. The OLC, LSB and MoJ, have agreed to keep this under review and may, if necessary, modify the basis of apportionment by agreement of all parties either in respect of future periods, as is appropriate. The parties will agree the timetable for any further review thereafter.

6.1.2 Chief Exec

This function includes the budgeted costs for the CEO, Chief Ombudsman, DCS and administrative support staff. Interim resource in 2015/16 was to be replaced by permanent heads by the end of 2015. Increase in headcount represents a part time board secretary and an executive assistant. Other costs comprise an allowance for Board paper production and various offsite meetings and events which may be required over the year.

6.1.3 HR

In addition to traditional transactional HR activities, the HR function provides internal communications, administers training and recruitment, and is responsible for health and safety. The increase in headcount represents a senior HR advisor. Other costs comprise the Life assurance costs for all staff, HR legal support and advice, plus administration costs of other benefits and occupational health activities.

Training and recruitment budgets are costs are shown separately below.

6.1.4 IT and telecoms

The IT function provides onsite IT desktop support as well as managing LeO's outsourced IT services, and telephony providers as well as MI for LeO's management, Operations, and Policy and Communications teams. LeO's project and change management and business analysis capability also sits within this function. IT staff costs in 2015/16 have included some interim costs to manage the IT function and business transformation programme, in addition to further interim costs for internal development of the new case management system to meet CMC go live deadlines. Seconded resource from the operations function was also used to provide user acceptance testing. A medium term increase in heads and related costs is required in order to facilitate a step change in the professionalism with which our IT services are delivered, and to move our focus to strategically aligned activities that provide significant business benefit to the organisation.

Other costs comprise the costs of LeO's outsourced managed IT services, Telephony call costs plus break-fix and maintenance expenditure required for LeO's desktop IT estate. LeO's outsourced IT contract ended in June 2015 and the migration of this

service to a new lower cost “Cloud” based platform is still in progress. Cost estimates for this alternative service have been included in the 2016/17 budget.

6.1.5 Finance

The Finance function provides financial planning and analysis in addition to day to day management accounting, financial transaction and payroll processing functions. LeO’s Staffing levels for 2016/17 are assumed to remain broadly unchanged with the exception of the addition of a procurement specialist. Other costs comprise statutory External audit and internal audit services. Internal audit services moved from KPMG to the MoJ internal audit service with effect from April 2015. The budget for internal audit has been held steady despite reduced day rates in order to ensure that adequate resource is available to the OLC.

6.1.6 General Counsel & Compliance

The General Counsel & Compliance team primarily provides and coordinates legal support for the OLC in addition to providing legal advice on casework to Ombudsmen and Operations staff in addition to managing the defence of challenges to Ombudsman determinations. In addition the team deals with FOI and DPA requests and provide administrative support for the service complaints adjudicator’s reviews of complaints about LeO’s service.

External legal costs are incurred as a result of defending challenges to Ombudsman decisions. Other costs primarily comprise subscriptions to legal journals and advice providers and costs of the external service complaints adjudicator.

6.1.7 Operational Insight and Engagement

The Operational Insight and Engagement function provides stakeholder liaison, external communications and research and analysis. Staff costs in 2015/16 were increased as a result of the use of interim resource. Costs for 2016/17 are anticipated to reduce as a result of lower costs and the combining of 2 senior roles in the team.

Other costs relate to media monitoring, public relations management costs. Research and analysis costs are budgeted for as direct costs within the External research heading.

6.1.8 Research and Surveys

Research & Survey costs are anticipated to increase slightly in 2016/17 due to a full commitment for additional research and understanding and an overflow in timing from 2015/16 outstanding projects.

Other costs are allocated for external expenditure on specific equality and diversity initiatives which are managed within this team. Any research, analysis or other external expenditure relating to the activities of this team are to be drawn from the relevant research, analysis and insight budgets.

6.1.9 Premises and facilities

Facilities staff costs include the costs of two individuals who, in addition to providing facilities management and house-keeping, also provide reception services. Other Premises costs include rent, rates and service charges, plus electricity charges and costs of outsourced soft facilities management services (cleaning etc.). We moved to

smaller, lower cost premises in early 2015 therefore costs for 2015/16 were already correspondingly reduced.

Dilapidations costs for our former premises were provided for in full in 2013-14. To the extent that we are able to mitigate these dilapidation costs the release of any surplus provision remains outstanding and is not realised in this budget.

6.1.10 Training, learning and development

The indirect training costs budget reflects the requirement (and commitment) to ensure that support teams continue to develop their skills and capabilities. In addition there are other activities (for example complaint handling, equality and diversity, data protection etc.) that are generic to both CMC and Legal employees and which are budgeted for as indirect costs. The budget also includes other learning and development expenditure designed to improve management and leadership, as well as staff engagement activities. Due to the expected changes facing the organisation and strict spending controls over 2015/16, very little spend occurred out of its budget. Additional resource has been allocated to these activities in 2016/17 for outstanding projects.

6.1.11 Recruitment

There were a number of senior posts filled within 2015/16, the specialist nature of which required an agency search and selection approach. One such post remains in 2016/17 and therefore is budgeted. In addition, IT, procurement and HR posts remain outstanding.

6.1.12 Travel & Subsistence

Travel and subsistence costs reflect the relevant budgets for all indirect cost functions. These are assumed to remain broadly in line with 2015/16 expenditure levels. Travel or subsistence costs involved in training, communications or other activities designed to improve complaints handling by feeding back issues and common themes to the industry, are expected to be covered from the appropriate external research, insight and analysis budget.

6.1.13 Depreciation and impairment

The useful economic life of fixtures and furnishings was extended from 5 years to 10 years in 2013/14. Equipment not in use was disposed of, or impaired to its residual value, during 2013/14 and 2014/15. Leasehold improvements for our new premises are to be amortised to the end of the lease term at the end of August 2024.

The replacement of our existing IT infrastructure started in 2015/16 and continuing is planned to be achieved by migration to cloud based services rather than through the acquisition of new capital equipment. There is a requirement for continued development of the CRM system to ensure that required efficiencies are achieved.

IT hardware has also reached the end of its life and now threatens the day to day efficiencies therefore a complete refresh of laptops is required and budgeted.

Depreciation on capital expenditure incurred during 2016/17 is anticipated from the point at which these assets are brought into use.

7 Sensitivity analysis

The key factors in addition to operational headcount which affect the ability of the organisation to deliver an effective and timely service are contact and case demand volumes, investigator efficiency. These factors are broadly similar for Legal and CMC activities:

Contact Volume: A 1% change in Contact Volume in legal activities would generate a change of c.550 contacts and around 70 cases per annum. This results in a change in the requirement for investigators of +/- 0.70 FTE therefore would require no changes to extra resource. For CMC activities a 1% change in contact volume is expected to result in around an extra 20 cases per annum requiring no changes to existing resource.

Cases Accepted: A 1% change in the conversion rate at which Legal cases are accepted (from 12.5% conversion to 13.5%) results in a change of 535 Cases per annum and a corresponding change in the number of investigators required of +/-5.8FTE (+/-£197k per annum payroll costs plus recruitment and training costs). For CMC activities a 1% change in the rate at which cases are accepted would result in around 175 extra cases per annum requiring an additional 1.0 FTE investigators based on assumed productivity levels.

Investigator efficiency: For legal activities a 0.25 cases per month change in investigator efficiency results in a corresponding change in the number of investigators required of +/-2.0 FTE Investigators over the medium to long term (+/-£68k per annum payroll costs plus recruitment and training costs). For CMC activities a 0.4 cases per month change in investigator efficiency leads to a change in the number of investigators required of +/-1.0 FTE Investigators over the medium to long term (+/- £38k per annum).

Operational stepped costs for legal activities both CMC and Legal Activities are incurred in the form of a requirement for 1 additional/fewer Investigation Team Leader (+/-£47k per annum payroll costs plus recruitment and training costs) for each addition/reduction of 12 FTE investigators, and for 1 additional/fewer Operations Manager (+/-£57k per annum payroll costs plus recruitment and training costs) for each addition/reduction of 50 Investigators.

We have plans in place that would allow us to respond to temporary increases in demand of 10% to 20%. These plans are summarised in Appendix I, however an increase in headcount would require additional budget authority from MoJ and or the LSB, and possibly additional grant in aid cash flow support in year. The cost reduction activity of 2013-14 and onwards has reduced our ability to respond quickly to significant shifts in demand. We believe that it is sensible to accept this increased risk in the light of the stability of demand over the last three years and the cost savings that this allows.

8 Key operational risks and mitigating actions planned

The key risks to the achievement of the budgeted expenditure are detailed below. These apply in principle to both our CMC and Legal activities:

8.1.1 Variations from planned contact and case volume

A short term increase in calls to the service is manageable through the re-deployment of investigator resource to the Assessment Centre. All Investigators are able to work in the Assessment Centre. In the event that contact volumes fell substantially, we would review the underlying causes of this change to ensure that this was expected to be a persistent change, and suspend replacement of leavers from the Assessment Centre until the causes were more clearly understood.

An increase in case volumes, whether generated by an increase or shortfall in contact volumes or by a change to the conversion ratio, would affect the investigator resource pool. The initial consequence of a significant increase above that anticipated is likely to be a backlog of cases waiting for investigation and deterioration in the speed with which we resolve cases (our Timeliness KPI).

These risks are mitigated through our recruitment strategy and flexible working policies. Our flexible working policies allow employees to increase their hours over the short term and to recover these additional hours in the form of “time off” in future months. This provides some time to recruit additional investigator resource, although this extra time would need to “unwind” at some point. We have also put in place arrangements to enable us to quickly recruit additional investigator resource to respond to any medium term increase in demand (See Appendix I). Although these new investigators will not initially deliver the same efficiency as our established investigators, the additional resource will enable us to minimise any backlog that arises and provide the additional capacity required to eliminate it.

In the event of a significant shortfall in case volumes, management would initially require any flexitime to be used up and freeze any planned recruitment activity while determining whether the change was persistent or permanent. It takes a substantial period to recruit and train an investigator, and then for them to become fully efficient. Accordingly, management would only take action to implement any redundancy plans once excess resource capacity had been established as likely to be long term.

As a result of the Ombudsman’s commitment to ongoing improvement and cost reduction, the organisation has reduced its capacity to deal with a significant increase in demand. The impact of such a sudden upturn would be more significant than in the past. We believe that, after five years of operation, this is an appropriate response to what has historically been a steady level of demand.

8.1.2 Planned Investigator efficiency is not met

Investigator efficiency is key to our resource planning and overall cost; a relatively small change in investigator efficiency makes a significant difference to the number of investigators required to maintain the quality and timeliness of our service.

We have mitigated this risk by making a prudent assumption based on actual achievement. To manage this risk, we monitor our work in progress, the rate of cases accepted for investigation and cases resolved weekly, and our Investigator efficiency levels. These are checked on a monthly basis to ensure efficiency levels are within the expected range.

We continually review our business process and the way that we perform our investigations, seeking to streamline and improve these. In the event that planned levels of efficiency were to fall significantly below or above those expected we would adjust investigator resource while we work to restore and achieve the required efficiency levels.

8.1.3 Staff turnover varies significantly from plan

The budget allows for a natural turnover in operational staffing of around 1.0 FTE per month on average. This is based on the staff turnover trends experienced over the past 12 months. Should this rate of staff turnover alter, this would create pressure on the budget. If staff turnover decreases headcount and costs will run in excess of budget. In this scenario the management team will review long term staffing requirements to consider whether a voluntary or compulsory redundancy programme is necessary. Conversely, if staff turnover is higher than forecast, this will result in increased recruitment costs and headcount running potentially below budget together with increased risk of operational disruption.

With the recent classification of the organisation's benefits scheme as novel and contentious there is currently significant uncertainty as to the future structure of this element of employee's remuneration packages and hence increased risk of higher turnover. This risk manifests itself both from the potential impact on staff turnover arising from the uncertainty regarding the future of this part of employee's remuneration, and from the potential impact upon staff turnover (and motivation) in the event that the OLC is required to modify these benefits in a manner that employees regard as detrimental.

The management team will continue to review staff turnover, as well as activity and efficiency levels to determine whether or not to bring forwards the point at which recruitment of replacement investigators will be initiated.

The management team have also mitigated both staff turnover and volume variation risks by planning to recruit and train smaller blocks of operational staff to enable us to more closely meet the demands of variations in activity and changes in headcount.

8.1.4 Large legal costs associated with judicial reviews

To date we have had only one material judicial review which has had a significant financial impact through third party costs requiring settlement. However, there are a small number of challenges ongoing. The nature of these challenges means that should a significant challenge develop, the costs of defending our position may be material.

The OLC and management team manage this risk through regular discussion with General Counsel.

9 Other assumptions

9.1 Other Assumptions

All VAT-able costs have been budgeted to include VAT at 20%.

9.2 Pay Policy & Revalorisation:

During 2015-16, and whilst considering the regularisation of staff benefits, the pay policy was looked at specifically with a view to removing automatic progression and introducing a system of promotion. This has been considered by both the Ministry of Justice and HM Treasury, with the latter confirming that our new approach is one of promotion. From 1 April 2016 staff will normally enter on a lower pay point for each grade below market rates, and will then have the opportunity to apply for promotion to the market rate within a specified time bracket. Promotion will not be automatic and will be dependent on satisfactory performance and a line manager recommendation and will have to be approved by a senior manager. The costs of this new policy are reflected in staff costs.

An average of 1% has been budgeted for revalorisation from April 2016 in line with Cabinet Office pay guidance.

National Insurance: Employer's National Insurance has been budgeted for based on the current rate of 13.8%.

Average Employer's Pension contribution: LeO operates a defined contribution scheme. Average Employee contribution to the LeO pension scheme is around 4%. LeO contributes twice the employee contribution up to a maximum of 10%. With auto enrolment of employees into the pension scheme, the take up stands at approx. 93 % of all employees. An average Employer's Pension contribution assumption of 7.4% for existing and 10% for new staff has been used for 2016/17 which reflects current pension costs to the organisation.

Core benefits: Death In Service and Group Income Protection Benefits are in place in line with our remuneration policy and these benefits have been included as part of HR indirect costs budget.

Flexible Benefits: As part of the organisational set up a flexible benefit scheme was originally included in the total remuneration package. Employer costs of the Flexible benefit scheme were capped at 3% of basic pay. As noted above the PAO determined this pay element to be novel and contentious and as such the scheme will not continue into 2016/17 Budget year.

10 Capital Expenditure & Cash flow

10.1 Capital Expenditure

Anticipated Capital expenditure	£'m
Case Management developments	0.16
Desktop hardware	0.20
Office Facilities	0.10
Total	0.46

IT Capital expenditure

Our existing onsite IT hardware (Laptops, Monitors etc.) will need to be replaced during 2016/17 because most of these will be 6 years old in August 2016 and are now beyond their shelf life. The budget allows for the estimated costs of this replacement activity to occur in the early part of 2016/17.

Ongoing Case management developments

As part of the continued development to our case management system, we anticipate being able to deliver most enhancements using in house resource. There remains a phase of development which will need some external development resource. The budget allows for this activity throughout 2016/17

Office Facilities

Having moved to new premises in 2014/15 we anticipate only minor expenditure on office facilities during 2016/17. Business reorganisation requirements may require some minor works to take into account the optimal use of space in 2016/17

10.2 Cashflow

We anticipate a cash balance at the end of 2015/16 of c. £18.4m after receipt of levy funding in respect of 2015/16 of £11.0 million from approved regulators and Grant in Aid receipts of £1.7m in respect of CMC activities. For 2016/17 we forecast expenditure before depreciation and amortisation for our Legal activities is £11.1 million. We anticipate case fee cash collections of £1m and Capital expenditure of £0.46m and hence a cash requirement of just over £10.5 million. We therefore anticipate a cash balance at the end of 2016/17, before receipt of levy funds, of £7.7 million. We do not, therefore, expect to require additional Grant in Aid to support our legal activities during 2016/17.

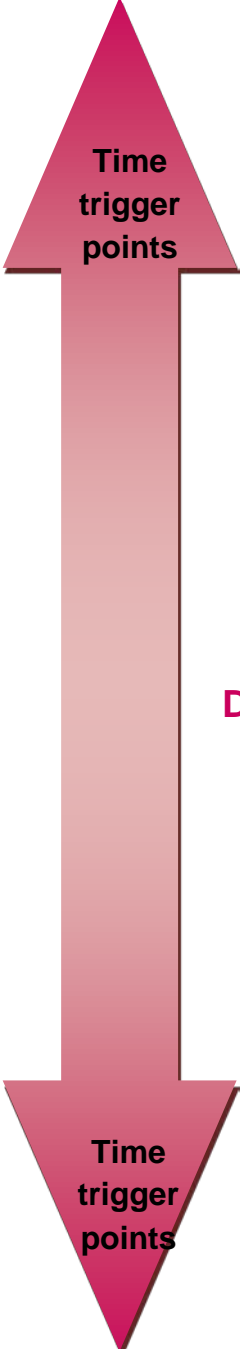
Implementation and operating costs for CMCs are accounted for separately and recovered from the Ministry of Justice in accordance with agreed funding arrangements through Grant in Aid.

11 Approval

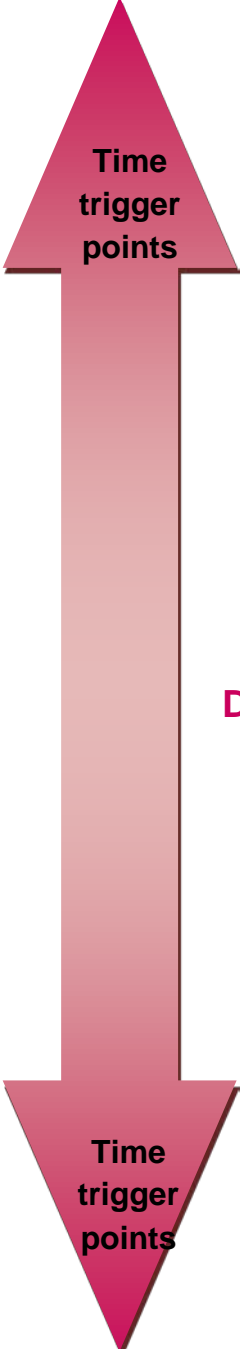
The Legal Services Board is requested to approve the Budget for the year 2016/17.

Appendix I

Activities & timeframes

 <p>Time trigger points</p>	<p>Month 5 onwards Permanent</p> <ul style="list-style-type: none"> • Procured panel of agencies who are pre-briefed • Recruitment takes 12 weeks + 4 weeks training • Regular cycle of recruitment (quarterly) to replace turnover and maintain profile of LeO as an employer
	<p>Months 3 & 4 Temporary</p> <ul style="list-style-type: none"> • Business case to MoJ for approval (6 week process) • Contract staff can be recruited and trained in 8 weeks
	<p>Months 1 & 2 Existing</p> <ul style="list-style-type: none"> • Mixed workforce including, contract / agency staff and permanent staff on variable hours contracts • Ask staff to work extra hours and pay or 'bank' these against time off in lieu • Increase hours on variable hours contracts • Maintain transferrable skills so that staff can be re-deployed (e.g. Investigators to Assessment Centre)

DEMAND

 <p>Time trigger points</p>	<p>Month 1 Existing</p> <ul style="list-style-type: none"> • Bring all existing work up-to date and reduce work in progress • Increase training, encourage use of banked hours and take up of annual leave • Reduce hours on variable hours contracts Use resource to create knowledge, complete improvement projects and encourage internal secondments • Encourage take up of part time contracts (with option to revert)
	<p>Month 2 Temporary</p> <ul style="list-style-type: none"> • Release contract staff
	<p>Month 3 onwards Permanent</p> <ul style="list-style-type: none"> • Put recruitment on hold • Unpaid leave • Business case to MoJ • Redundancy