Office for Legal Complaints

Budget 2017-18

LEGAL OMBUDSMAN

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1 Executive Summary

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 presented its initial budget principles and an outline budget to the LSB in November 2016. Since then, further work has been undertaken to update the proposed budget which the OLC approved on 8 March. We now request the Legal Services Board's approval of the proposed budget.

Strategic context

The context for the 2017-18 budget is set out in our consultation on the 2017-2020 strategy and business plan (**Appendix 1** provides the latest version of the draft strategy which we expect to publish in April). This sets out an ambitious agenda over the next three years, based on a vision of our impartial service adding value by driving improved professional standards and enhancing the UK's global reputation as a legal centre of excellence.

The environment is complex and dynamic, not simply because of the uncertainty and focus required to implement the decision to leave the European Union but also because of the scale of the changes associated with implementing the CMA's recommendations, which may lead to changes in LeO's jurisdiction. Beyond this, technological advances are radically reshaping the provision of professional services and sharing of legal expertise. We also need to manage the transition of the CMC jurisdiction to the Financial Services Ombudsman, which we anticipate will take place no earlier than October 2018.

The strategy highlights the importance of developing a stronger external focus, improving performance, developing our infrastructure and ways of working. The strategy will embed our customer service principles into everything we do – we know what our customers want of us, and our business plan will ensure we deliver this more consistently.

Our plans focus on modernising the organisation and explain the *Modernising LeO* programme we have initiated. This will develop a more integrated, end-to-end process to better serve our customers, implement a new staffing model and drive new business processes that underpin the new case management system we are developing. In the first phase of the programme, we are improving our under-performing IT infrastructure and devices, and will update our intranet and website. The second phase of the programme will allow us to develop a much more capable website and explore opportunities to offer alternative ways for customers to interact with our service, for example by considering a web based portal. The revenue budget includes some time-limited investment to help us deliver the programme and achieve longer-term efficiencies while protecting performance and service quality. This additional capacity directly addresses the challenge the LSB made in November about whether we had included sufficient resource to deliver such an ambitious programme.

Our customer service principles provide the foundation for the service we provide and the way in which we measure its quality. These link to our corporate values and are underpinned by service standards and behaviours. These principles are strongly influencing our ways of working and have enhanced our focus on quality. As a result, we are broadening the measures we use to assess the quality and impact of our service using a Balanced Scorecard based on the emerging new strategy.

A summary of the position against each of the LSB's specific acceptance criteria appears below:

Distribution of resources and income

We are proposing a total 2017-18 budget of **£14.63m**, with **£11.63m** allocated to the legal jurisdiction and **£3m** to the CMC jurisdiction. These costs are offset by case fee income of £0.94m legal and £1.07m CMC. Headcount remains unchanged in each jurisdiction compared with 2017-18 at 168 legal and 28 CMC, with indirect staffing remaining stable despite additional fixed-term roles for the Modernising LeO programme. We plan to implement a new staffing model and structure no later than April 2018, the full details of which are still being worked through; the changes will not increase total numbers.

Key risks and mitigations

The main risks to delivery of the business plan remain similar to previous years, with the additional risk (and opportunity) relating to implementing the *Modernising LeO* programme.

We cover the impact of changes in demand in the next section. Wider risks to the credibility of the scheme will be managed through our external communications and engagement strategy.

The operational resource risk will be mitigated by the continuation of our successful programme of rolling recruitment, and the design, testing and implementation of our new, more flexible staffing model. The *Modernising LeO* programme will draw on key operational resources; we will mitigate the impact of this through additional temporary staffing.

We will build on existing work to strengthen our approach to quality and align it with our customer service principles by embedding the quality function within Operations, including an explicit focus on quality in our revised Balanced Scorecard, and by implementing our new structure, ways of working and case management system through *Modernising LeO*.

Predicted volumes and sensitivity analysis

Backlogs have impacted timeliness performance during 2016-17 and will continue to impact our workload in 2017-18. We are not able to increase the establishment when demand rises and would therefore need to implement management actions to maintain and improve performance. These would be similar to those taken in 2016-17 to manage down backlogs and queues, for example through innovations such as triage, and smarter work allocations.

Should demand decrease, we would not automatically reduce staffing levels. We would need to assess the cause of the reduction in demand, and whether it is a structural or temporary reduction. Vacancy management, outward secondments and reorganisation would be options for managing reduced demand.

As we control our front-line recruitment, and have agreed updated delegations with the MoJ we enjoy reasonable flexibility and control to manage fluctuations in demand.

CMC bad debt and transfer of jurisdiction

CMC bad debt expenses are expected to increase significantly. The forecast bad debt expense of £1m in the CMC jurisdiction reflects the fact that our scheme rules require us to charge a case fee in all cases where the fee is chargeable, even when it is highly unlikely we will be able to recover the fee, for example when a large CMC provider with multiple cases against them goes into administration. As such, we recognise the income and a corresponding bad debt expense where we charge a case fee for a large multiple CMC that is in liquidation.

To address the root cause of the high bad debt expenses in the CMC jurisdiction, we are preparing a consultation about changes in scheme rules which would allow us to waive case fees where there is little prospect of recovery, for example where a CMC was in liquidation. This would significantly reduce the levels of bad debt expense (and case fee income), but would not be implemented until April 2018.

Value for money

OLC is committed to achieving value for money through its oversight of the Legal Ombudsman's work. Value for money depends on providing excellent service with efficient business processes, and leveraging wider insights from the scheme to add value across the system. This builds up from the understanding we have of what a good service looks like from the development of our customer service principles and our focus on embedding these throughout our work.

We continue to achieve significant cost reductions, and will make critical investments in 2017-18 that should allow us to improve efficiency and reduce future costs in line with MoJ expectations. The purpose of the *Modernising LeO* programme is fundamentally to improve value for money by becoming more effective and efficient with the right staffing model, business processes and infrastructure.

We are developing a balanced scorecard for the new strategy that will help us measure our value for money through more precise measures of our effectiveness, efficiency and economy. Our business plan highlights, under objective 4, the work we will do to improve efficiency through new ways of working, more flexible resource models and development of our estates strategy.

Stakeholder responses to the consultation

The budget reflects the medium-term financial plan we submitted to the Ministry of Justice in December 2016; the CMC element, including bad debt expense, has already been part of the Lord Chancellor's fee process in August 2016 and has been discussed at senior level with the MoJ's finance team. The budget is in line with our spending review commitments.

The MoJ is aware of the critical importance of capital funding being available to support the Modernising LeO programme, and we understand MoJ confirmation of both our capital and revenue budgets for 2017-18 is imminent.

Our stakeholders' responses to our strategy and business planning consultation highlighted a number of points relating to the budget. The key issues were:

1. a recognition of the ambition of the strategy and business plan with a number of stakeholders questioning whether we had sufficient resources to deliver it;
2. a strong view from some stakeholders that we must not resource any work on redress for unregulated providers from the levy; this point was in the consultation document but will be made more prominently in the final strategy and business plan; and
3. a number of respondents highlighted concerns about longer-term efficiency targets in addition to the significant efficiencies already built in to the 2015-16 baseline, a point which is recognised by the OLC.

2 Forecast out-turn for 2016/17

Legal Jurisdiction	**2014/15 Actual**	**2015/16 Actual**	**2016/17 Out-turn**
Cases Investigated	7,635	6,416	7,000
Cost of the Ombudsman scheme	£12.8m	£11.6m	£10.7m *****

* This is an underspend against the original budget of £11.6m, reflecting the impact of spending and recruitment controls in the first half of the financial year, and the fact that we did not need to use budget set aside to cover some external professional service costs. The 2017-18 budget is much tighter and the restoration of our Accounting Officer status and changes to our approach to recruitment reduces the risk of further underspend.

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 36 months the OLC and LeO's management team have delivered the planned benefits of this cost reduction plan. The 2015/16 numbers included 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 2017/18 and the budget reflects this direction.

The CMC jurisdiction outturn expenditure is forecast at £2.1m, including £0.6m allocated from LeO's fixed overhead. This is in line with the 2016/17 operating budget for CMCs agreed with the MoJ.

3 Proposed budget

The proposed budget for 2017/18 is set out in Figure 2, split between Legal and Claims Management activities. These budgets are set out in more detail in Section 4 (Legal) and Section 5 (Claims Management) together with the current forecast outturn for 2016/17.

Since the presentation of our budget principles paper to the LSB on 23 November 2016, the total 2017-18 budget has increased by 2 per cent (£0.3m). This reflects the net effect of cost increases set out below offset by savings found primarily in the research, recruitment and learning and development budgets:

1. reflecting the challenge the LSB made in November about whether we had sufficient capacity to deliver the ambitious Modernising LeO agenda, we have added:

    a. £0.1m to cover a part-time programme manager and to back-fill operational staff devoted to work on the Modernising LeO programme;

    b. one-off costs associated with the Unified IT workstream of the Modernising LeO programme of £0.185m; this includes decommissioning costs for legacy systems and provision for uncertain costs associated with transition and revenue costs for our new IT infrastructure and telephony suppliers, for which commercial negotiations are ongoing; although the infrastructure procurement is progressing well, we do not yet know final costs, and we need to work with the new infrastructure supplier to specify our telephony requirements before we re-procure our telephony;

    c. one-off costs of £0.1m associated with the Enhance workstream of the Modernising LeO programme, principally to cover costs of implementing our new staffing model which puts in the best possible position to manage the loss of the CMC jurisdiction and which we had assumed would take place in 2018/19 when we presented the budget principles to the LSB in November; and

2. since November, Microsoft will increase their service and licence costs by more than a third (£0.08m) in their 2017 renewals, which combines one-off increases, a change in the licensing model and the usual annual inflationary increase.

Of the additional costs, only the MS licence costs (item 2) are recurrent.

	Legal Activities £’m	Claims Mgt Activities £’m	OLC Budget £’m
Levy income / Grant in Aid	10.70	1.92	12.62
Case Fee income	0.94	1.07	2.01
Total Income / funding	11.64	2.99	14.63
Direct Costs			
Staff	6.36	1.12	7.48
Other services	0.43	0.16	0.59
Unrecoverable case fees	0.12	0.95	1.07
Total Direct Costs	6.91	2.23	9.14
Total Indirect cost	4.73	0.76	5.49
Total expenditure	11.64	2.99	14.63
Planned cases investigated	7,000	3,400	
Capital expenditure			0.49

	Legal Activities	Claims Mgt Activities	Indirect	Total
FTE Headcount 2017/18**	168.3	28.0	47.2	243.5
FTE headcount 2016/17*	168.0	28.0	47.6	243.6

* **-** Forecast year end position

** - Average

4 Legal complaints budget

	Section	2016/17 Forecast £'000	2017/18 Budget £'000
Levy Income	4.1.2	9,749	10,697
Case Fee Income		912	940
Total Income		**10,661**	**11,637**
Staff Costs	4.1.3	6,070	6,363
Recruitment	4.1.3	5	16
Training	4.1.3	32	54
Travel & Subsistence		3	4
Printing, postage and scanning	4.1.4	174	185
Live chat service			4
Translation services	4.1.5	29	42
Research/ surveys / communications	4.1.6	77	114
Other services - subtotal		320	419
Unrecoverable case fees	4.1.7	101	120
Indirect cost allocation	6.1	4,170	4,735
Total Revenue Expenditure		**10,661**	**11,637**
Anticipated volume	4.1.1	7,000	7,000

Operational Headcount	2016/17 FTE *	2017/18 FTE ave**
Operations Management & Team Leaders	15.0	15.0
Ombudsmen	14.0	13.3
Investigators	98.0	98.0
Assessors	34.0	34.0
Coordinators / Administrators	7.0	8.0
	168.0	168.3

* - Forecast year end position
** - includes assumptions for leavers throughout the year

4.1.1 Legal activity volumes and expected demand for complaint handling

	Actual 2014/15	Actual 2015/16	Forecast 2016/17	Budget 2017/18
Number of cases accepted	7,635	7,018	7,000	7,000
Cases resolved (external)	7,371	6,362	6,700	6,700
Cases resolved (All)	7,862	6,763	6,825	7,000

The number of cases accepted to date during 2016/17 is slightly higher than the same period in 2015/16. As a result, we have budgeted similar numbers in the 2017/18 financial year. Seasonality has minimal impact on the number of cases accepted per quarter.

Following a build-up of work at the assessment stage of our process, there was a significant increase in the number of cases accepted for investigation in June 2016, which continued into quarter 2. This in turn created a build-up of work at the resolution stage of our process, and a number of initiatives have been implemented to address this build-up and achieve incremental improvements in performance. Importantly, as the number of cases accepted includes a significant proportion that will continue into 2018-19, the forecasts above will allow LeO to continue to reduce and ultimately eliminate the backlog of cases that we have already begun to reduce.

During the first 3 quarters of 2016/17, the areas of law that we have received the highest proportion of complaints about remain broadly comparable to 2015/16. The highest number of complaints were about residential conveyancing (23%), followed by family law, wills and probate, personal injury and litigation.

The OLC's 2017-2020 Strategy and Business Plan clearly sets out the strategic drivers that will impact the organisation during this three year period, including the Competition and Market Authority's market study, the potential for regulatory change and the wider economic context. We do not anticipate these strategic drivers, or any other changes impacting either the volume or profile of the legal complaints that we receive in 2016 /17.

4.1.2 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 legal ombudsman scheme, less Case fees charged; and
- 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

have recently concluded a call for evidence about changes to the charging structure for case fees. We expect to issue a formal consultation and should we receive consent for changes in the scheme rules, its impact is expected to be cost neutral.

4.1.3 Staff costs, recruitment and training

Direct recruitment and external training costs are expected to be broadly similar to those budgeted in 2016/17. Some training expenditure has been delayed in 2016/17, in part because of the time it has taken to secure approvals and to secure acceptable proposals from the CSL suppliers we are required to use, and will now occur in the 2017/18 financial year.

A key element of the Modernising LeO programme is to move to a new, more flexible staffing model. There will be some one-off costs involved in achieving this transition and achieving the right structure to deliver our new ways of working. We are finalising the timing of implementation, but are currently assuming there will be £0.1m one-off reorganisation costs in 2017-18. These are crucial to achieving efficiencies in future years, managing the loss of the CMC jurisdiction and working towards our spending review targets for 2019-20.

These one-off costs, plus the £0.1m budget for short-term staff cover to support *Modernising LeO*, are the main driver of the increased staff costs beyond pay increases. These one-off costs will not continue in to 2018/19.

4.1.4 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.

4.1.5 Translation services

This reflects the costs of translation (of correspondence and calls) 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. Budget 2017/18 remains at 2016/17 levels despite the reduced forecast outturn for 2016-17. Savings in the current year are still under investigation with the supplier to clarify the nature and integrity of the number.

4.1.6 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 budget covers independent monitoring of customer satisfaction at various stages of their engagement with our service. It also provides some additional budget to cover our research and analysis work which we are developing in conjunction with the wider regulator community on areas of mutual interest.

4.1.7 Unrecoverable cases fees

Historically, we have experienced a significant proportion of unrecoverable case fees. The budgeted bad debt expense for 2017/18 reflects levels of bad debt experienced during 2016/17 to date and compared to previous years. Bad debts arise mainly where a law firm has gone out of business during an investigation, by the time the complaint is brought to us or by the time it has been resolved. We have included a reserve for bad debt write-offs of £120k for 2017/18, the same as our 2016/17 budget.

5 CMC complaints budget

	Section	2016/17* Forecast £'000	2017/18 Budget £'000
Case Fee Income	5.1.2	611	1,074
Total Income		**611**	**1,074**
Staff Costs	5.1.3	910	1,124
Recruitment	5.1.3	3	10
Training	5.1.3	4	10
Direct Travel & Subsistence		3	5
Printing, postage, scanning & translate	5.1.4	24	42
Live Chat service	5.1.5	17	20
Legal fees		2	10
Research, surveys, communications	5.1.6	30	61
Other Services Subtotal		83	159
Unrecoverable case fees	5.1.7	465	951
Indirect cost allocation	6.1	631	760
Total Expenditure		**2,089**	**2,993**
Forecast / Budget GIA requirement		**1,478**	**1,919**

Business case	**£'000**	**£'000**
Expenditure	2,089	2,993
Case Fees	(611)	(1,074)
Business case GIA requirement	**1,478**	**1,919**

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Operational Headcount	**2016/17 Forecast FTE***	**2017/18 Budget FTE Average**
Operations Management & Team Leaders	3	3
Ombudsmen	1	1
Level 1 Investigators	14	14
Level 2 Investigators	8	8
External Affairs Officer/Apprentice	2	2
	28	28

Note: * = Forecast year end position

5.1 CMC Complaints – key assumptions

5.1.1 CMC activity volumes and expected demand for complaint handling

Learning from the experience of our first year of operation of the CMC jurisdiction (2015-16), we forecast that we would receive 18,000 contacts and 2,000 cases during 2016/17. The actual outturn numbers are now forecast to be 18,000 and 2,400 cases.

	Actual 2015/16	Forecast 2016/17	Budget 2017/18
Number of Contacts	16,488	18,000	20,000
Number of Cases accepted	2,438	2,400	3,400

The forecast was developed during the summer of 2016 based on the best available information and to inform the Lord Chancellor's fee. At that time we were experiencing a significant bulk incident. The figures reflect our assumption at that time that the number of bulk incidents would remain at three bulk incidents as in 2016-17 within the Claims Management jurisdiction. Multiple complaints are received about a single Claims Management Company (CMC). In 2016-17, the first bulk incident generated 775 cases, the second 389 cases and the third 282 cases.

The numbers above could be significantly affected should the number of bulk incidents differ and is obviously materially impacted by the small number of very high impact incidents.

Forecast figures for CMCs report the number of cases accepted, unlike legal where we report externally on the number of cases resolved. This reflects the lack of baseline data about CMCs and the way in which we report caseload to the Lord Chancellor for her fee. There is no significant backlog of cases in the CMC jurisdiction to reduce. Having eradicated the historical backlog and notwithstanding any future bulk incidents, we now have the correct staffing model to deal with the anticipated volumes of work and continue the improvement in performance in the CMC jurisdiction.

The majority of complaints about CMCs continue to involve claims made in respect of financial products and services, with 95% of all complaints accepted falling into this regulated area. Within the financial products and services sector, 95% of those complaints received relate to claims for mis-sold Payment Protection Insurance (PPI).

Analysis of the external market for claims management activity indicates a continued downward trend in respect of the number of authorised CMCs, although the decrease slowed between 2015 and 2016. The CMC landscape is different from our experience of working with Legal service providers, particularly in respect of a CMC's ability to cease trading. We continue to consider whether a CMC is a successor to another when assessing complaints against closed companies, which is factored into our planning assumptions.

There are a number of planned changes within the CMC landscape over the short to medium term, including the Financial Conduct Authority (FCA) consultation on implementing a time bar for PPI complaints, and the Claims Management Regulator's consultation on the proposal to cap fees charged by CMCs operating within the financial products and services sector. These changes are likely to impact on both the volume and profile of complaints; however, it is not anticipated that they will affect 2017/18 forecasts.

In March 2016 the Government's report into the regulation of CMCs was published, recommending that regulation moves to the Financial Conduct Authority. As a result, a further decision was made that service complaints would follow regulation and therefore CMC complaint handling would transfer to the Financial Ombudsman Service at a date to be decided. The latest indicative timescale provided by the MoJ suggests the transfer will not take effect before October 2018 although it is very possible that the transfer date could be further delayed due to the requirement for legislation.

In the absence of a definitive date it is difficult to undertake detailed planning in respect of the transfer. We are in close liaison with colleagues at the MoJ and Claims Management Regulator in order to understand the impact of the transfer, and have attended an initial fact finding meeting with the FCA to share our experiences of dealing with service complaints against CMCs. Implementing our new staffing model will support our plans to manage the transition of the CMC jurisdiction with minimal disruption to our workforce.

In the meantime, our planning assumptions for the transfer of the Claims Management Jurisdiction to the Financial Ombudsman Service are that the CMC jurisdiction will transition to the Financial Ombudsman Service no earlier than October 2018; in the context of significant uncertainty about the precise timing of transition and detailed approach to this, we have reflected MoJ's requirement to include CMC costs in all future years' budgets in our medium-term financial plan and assumed that:

- CMC costs will continue to be ring-fenced from the legal budget and separately funded;
- indirect costs are not expected to reduce significantly as a direct result of losing the CMC jurisdiction having reduced since we took the additional jurisdiction on;
- we aim to avoid compulsory redundancies by implementing a new structure and using turnover and fixed term contracts/contractors in the CMC jurisdiction; and
- a separate budget will be required to cover any transitional costs associated with the transition.

5.1.2 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. We are currently considering a consultation about making a change to the scheme rules which would allow the ombudsman to waive a case fee where recovery was deemed highly unlikely. It is estimated to be cost neutral as the reduction in bad debt expenses would be offset by a corresponding reduction in case fee income in the CMC jurisdiction.

5.1.3 Staff costs, recruitment and training

Staff Costs are budgeted based on anticipated headcount as outlined on page 15, which is unchanged from 2016/17.

Training costs are in addition to generic training that would be provided to all LeO staff and which is included within the indirect cost allocation. Budget 2017/18 remains in line with the 2016/17 budget. Underspend in the year reflects the delays with procurement due to the change of MoJ supplier.

Wherever possible recruitment is sourced directly without incurring charges but we carry a budget to help source staff rapidly which can be an issue given turnover and now that we know we will lose the CMC jurisdiction. Budget 2017/18 remains in line with the 2016/17 budget to cover potential agency fees. Underspend in the year reflects the ongoing success of direct campaigns throughout the year.

5.1.4 Printing, postage, scanning & translation

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. Translation reflects the costs of the translation of correspondence and calls with complainants into appropriate languages in order to ensure that our service is accessible to all.

5.1.5 Live Chat Service

Online live chat service costs have increased due to the impact of accruals on costs in 2016-17.

5.1.6 External research, insight and analysis

In order to help create an improved complaints handling system and practice within the CMC industry, LeO will continue to build upon developments introduced in previous years. These include activities such as professional training courses and relationship management with CMCs to help feedback issues and common themes to the industry, as well as collecting our own and independently gathered feedback from those using our CMC service.

5.1.7 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 and 2016/17 with the collapse of major firms in the sector leading to both an increase in case fees issued and immediately being classified as unrecoverable. We are forecasting for a number of large firms to go into liquidation in 2017/18 following the market trend, reflecting our current pipeline of cases and intelligence from the Claims Management Regulator.

CMC bad debt expenses are expected to increase significantly. The LSB has asked us to explain the rationale behind the significant increase in 'bad debt contingency'. We should clarify that it is not a bad debt provision but a bad debt expense arising from writing off case fees. The forecast has been developed based on our understanding of the current caseload and case mix, and intelligence from the CMC Regulator, and is as stated in the estimate we provided to inform the Lord Chancellor's fee in August 2016.

The forecast bad debt expense of £1m in the CMC jurisdiction reflects the fact that our scheme rules require us to charge a case fee in all cases where the fee is chargeable, even when it is highly unlikely we will be able to recover the fee, for example when a large CMC provider with multiple cases against them goes into administration.

It is very important to explain that although the bad debt expense has increased, the case fee income for CMCs has increased by a corresponding amount; if bad debt fell, income would fall by a corresponding amount. This means that while there has been an increase in the expense, the net impact is neutral.

We have recently concluded a call for evidence on potential changes in the scheme rules, which includes the possibility of enabling the ombudsman to waive case fees where there was little prospect of recovery. We expect to commence a consultation on changes to the scheme rules which would confirm our ability to waive case fees where there is little prospect of recovery.

Should we secure necessary consent from the LSB and Lord Chancellor to change the scheme rules in this way, we would expect a significant reduction in CMC bad debt expenses (and case fee income recognised) from April 2018. The changes would address the root cause of the increasing bad debt expense and lead to the bad debt costs falling alongside a corresponding reduction in the case fee income we recognise.

The estimated CMC bad debt expense for 2017-18 is based on the following assumptions set in August 2016 as part of our submission for the Lord Chancellor's fee:

- forecast demand of 3,400 cases (the 'medium' scenario of three planning scenarios undertaken, which had the highest probability);
- the assumption that 65% of cases (2,210) will be for complaints against bulk entities in which we expect a fee to be charged, in addition 35% of cases will be against regular CMC entities of which 40% will attract a case fee (476); and
- 35% of case fees raised against regular CMC firms are potentially not recoverable and, based on our experience to date (causing case fees of £66,400 to be written-off), while all case fees raised against bulk CMC companies have been written off (which would cause a bad debt expense of £884,000); however, we will regularly review bulk cases to ensure that where recovery is possible we will charge a case fee.

6 Indirect cost budget

6.1 Indirect costs summary

	Section	2016/17* FTE	2017/18** FTE	Staff costs 2016/17 £'000	Staff costs 2017/18 £'000	Other costs 2016/17 £'000	Other costs 2017/18 £'000	Total 2016/17 £'000	Total 2017/18 £'000
Chief Exec	6.1.2	5.8	3.8	431	342	3	2	434	344
Office of the Chief Legal Ombudsman	6.1.7		6.8		329		43		372
HR	6.1.3	3.8	4.8	176	344	115	25	291	369
IT and telecoms	6.1.4	15.0	15.0	607	724	955	1,282	1,562	2,006
Finance	6.1.5	5.0	5.0	208	213	52	55	260	268
Legal	6.1.6	3.0	4.0	184	208	77	54	261	262
Operational Insight & Engagement ***		13.0	-	628	-	40	-	668	-
Data & Insight	6.1.7/8	-	3.9	-	186	113	128	113	314
Quality	6.1.7	-	1.9		99		12		111
Premises and facilities	6.1.9	2.0	2.0	48	50	614	642	662	692
Training, learning & development	6.1.10	-	-	-	-	64	49	64	49
Recruitment	6.1.11	-	-	-	-	55	34	55	34
Travel & Subsistence	6.1.12	-	-	-	-	31	31	31	31
Governance / Other	6.1.13	-	-	-	131	12	-	12	131
Depreciation and impairment	6.1.14	-	-	-	-	388	512	388	512
Total Indirect Headcount & Costs		47.6	47.2	2,282	2,626	2,519	2,869	4,801	5,495
							Indirect Cost allocation to Legal activities	(4,170)	(4,735)
							Indirect cost allocation to CMC activities	(631)	(760)

* - Forecast year end position** - Average FTE over the 12 months to 31 March 2018 *** Team restructured into OCLO, Data and Insights and Quality, with other staff moving into People and Legal, and two FTE moving to OCLO from the CEO's office in 2016/17

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 in respect of future periods. The parties will agree the timetable for any further review thereafter.

6.1.2 Chief Executive's office

This function includes the budgeted costs for the CEO, Director of Corporate Services, Board Secretary and executive assistant. This is a smaller function than in 2016-17 due to moving the Chief Legal Ombudsman and their support to the Office of the Chief Legal Ombudsman. Other costs comprise corporate memberships and subscriptions.

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 and occupational health Other costs in the department comprise life assurance and income protection costs for staff, HR legal support and advice, and occupational health. Staffing costs represent a full year of service for all staff and the inclusion of a full year of the head of HR role.

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 managed service providers for IT and telephony. LeO's project and change management and business analysis capability also sits within this function.

The team is temporarily larger in 2017/18 to enable us to make the necessary changes to our IT systems and infrastructure. During the year, we will replace our infrastructure supplier, procure new telephony support, complete the build of a new case management system, replace our Intranet site, stabilise our external website and complete the process of rolling out new end user devices.

As we rationalise the legacy of poorly aligned contracts and activities, our future IT costs will reduce and the business will benefit from more reliable and smoother IT support for our services, delivering more significant efficiency gains across the organisation and improvements in service quality.

LeO is currently transitioning to a new infrastructure support provider following a competitive procurement which will cause a number of one off costs in 2017/18 (investment in transition and exit costs for the outgoing supplier), along with decommissioning costs for old systems (£0.185m).

Other costs comprise the costs of LeO’s outsourced managed IT services (infrastructure and case management support), telephony call costs plus break-fix and maintenance expenditure required for LeO’s IT assets.

6.1.5 Finance

The finance team provides financial planning and analysis in addition to day to day management accounting, financial transaction and payroll processing functions. LeO’s Staffing levels for 2017/18 are assumed to remain unchanged an additional procurement resource. Cost changes represent this additional head plus a full 12 months of the head of finance costs. 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 remained stable to ensure that adequate assurance is available to the OLC.

6.1.6 Legal

The legal team provides and coordinates legal support for the OLC and oversees compliance activity. It also provides legal advice on casework to Ombudsmen and Operations staff. It also manages the defence of challenges to Ombudsman determinations, deals with FOI and DPA requests and provides administrative support for the service complaints adjudicator’s reviews of complaints about LeO’s service. Staff cost changes represent the change in the staffing model within the team since we restructured and removed the General Counsel role from our establishment in September 2016.

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 Office of the Chief Legal Ombudsman and Data and Insights Team

One of our draft strategic objectives is to ‘build our capability to understand, engage and influence the legal service and CMC environments’.

We are currently restructuring to ensure we have the right focus to deliver the new strategy. With effect from 1 April, we are disbanding the existing Operational Insight and Engagement function which provides stakeholder liaison, external communications and research and analysis, and creating a separate teams in the form of the Office of the Chief Legal Ombudsman, Data and Insights and a Quality team embedded reporting through our Operations function. This will increase our capability in terms of data analysis, and provide a much stronger function to support the externally-facing work of the Chief Legal Ombudsman. The changes also reduce our long-term cost base.

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

6.1.8 Data and Surveys

Data and survey costs are anticipated to increase slightly over forecast in 2017/18 but remain below the 2016/17 budget of £179k. This work is critical to assessing customer feedback about our service, and enabling LeO to provide effective feedback and insight to the sectors and professions we work with.

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 and we have confirmed with MoJ colleagues would not be considered to be capital in nature under ESA10.

6.1.9 Premises and facilities

Two members of facilities staff provide facilities management and reception services. Other Premises costs include rent, rates and service charges, plus electricity charges and costs of outsourced soft facilities management services such as cleaning. Increases in costs result from the impact of credits applied during the 2016/17 year.

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. Changes in the costs above reflect a reduction in line with the increase in direct training and are simply allocation differences.

6.1.11 Recruitment

Recruitment of senior posts has all been completed during 2015/16 and 2016/17 therefore the lower budget reflects standard running costs only as wherever possible recruitment is sourced directly without incurring charges.

6.1.12 Travel & Subsistence

Travel and subsistence costs reflect the relevant budgets for all indirect cost functions. These are assumed to remain in line with 2016/17 expenditure levels in line with the current travel restrictions. 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 budget.

6.1.13 Governance / Other

We have a strategic objective to modernise the Legal Ombudsman to deliver continuous improvement in performance. 2017/18 is the key year of our modernisation programme with significant investment in redesigning our processes, ways of working and structures, and ensuring we have IT systems and infrastructure that enable us to deliver excellent service.

Reflecting the LSB's challenge in November 2016 about whether we had included sufficient resource to deliver the programme and maintain service levels, we have developed our programme plans and included £0.1m to cover short-term appointments for specialists to bring key skills to support the programme, both technical skills and short-term back-fill for change agents and operational staff helping design new processes and testing our new systems, and some modest headroom to cover contingencies.

If we decide that bonuses should be paid, the staff bonus scheme will reward staff delivering excellent all-round performance and demonstrating our values, behaviours and customer service principles. Bonus payments are taxable. The selection of staff comes from the whole organisation, rather than as a percentage of each team's staff. A provision of £50k is included in the budget. The 2016/17 bonus is spread throughout the departments.

The introduction of the government apprenticeship levy has meant that additional costs of £23k are now required in the budget and appear in this line.

The budget includes a negative adjustment of -£42k to reflect the impact of changes after submission of the Lord Chancellor's budget for CMC's in order to represent the true consolidated budget total.

6.1.14 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.

IT hardware has reached the end of its life and therefore the refresh of end user devices in Q4 2016/17 will mean full year charges in 2017/18.

Capital investments in 2017/18 represent the replacement of the case management system, website and infrastructure required additions.

Depreciation on capital expenditure incurred during 2017/18 is anticipated from the point at which these assets are brought into use. The significant increase in depreciation costs reflects the Modernising LeO investment in end user devices and the case management system.

7 Sensitivity analysis

In our business planning, we have tested the central case (7,000 legal cases and 3,400 for CMC as forecast for the Lord Chancellor's fee) against two scenarios, one with an increase of a 25% reduction and a 15% increase in demand. Ultimately, the pipeline of work in progress that will flow from the current financial year into 2017/18 means that it is unlikely there would be a material change in demand that would require a change in the budget in-year.

Reduction in demand for our service

If we were to experience a reduction in demand for our service, performance against timeliness and customer satisfaction KPIs would improve. However, the cost per case and investigation would significantly increase. In addition, income via case fees would reduce which could impact on levy funding and Grant in Aid.

Inevitably in this situation we need to understand why demand was falling. Depending on whether this was due to a permanent shift in levels of demand, we would need to consider reducing the workforce through effective vacancy management, offering secondments to other organisations and as a last resort considering compulsory redundancies, while managing the impact on staff morale with great care.

Increased demand for our service:

An increase in demand for our service would be likely to have a negative impact on performance, causing significant backlogs at key stages within the business process, impacting timeliness and customer satisfaction KPIs. This could lead to increased scrutiny of our performance and early dialogue with LSB and MoJ colleagues would be appropriate both in respect of the issues and impact.

Cost per complaint and investigation would significantly decrease.

There is no additional budget for increasing the establishment, therefore we would use existing resource more flexibly and up-skill staff to support impacted areas of the business. The impact of this scenario has been demonstrated by performance during 2016/17 as a result of backlogs in the assessment centre impacting the number of cases accepted in June 2016.

8 Key operational risks and mitigating actions planned

The risks to operational delivery remain similar to those outlined in previous years, including for example variations in demand, efficiency and resource levels. However, we have a revised approach to reporting against strategic risks for the forthcoming year. The revised operational risks fall within the risk group of ‘delivering the scheme’ and include:

- **Credibility** – scheme loses credibility as a result of service failure
- **Demand** – delivery of scheme compromised by unplanned changes
- **Operational resource** – insufficient resource to deliver scheme effectively
- **Quality of service** – failure to consistently deliver a quality service.

These risks are mitigated by effectively monitoring performance both in quantitative and qualitative terms which allows appropriate action to be taken before significant issues are experienced. In addition, we have created flexible resource groups, particularly at Ombudsman level, which we can ‘call off’ when work levels demand. Finally, we have a robust quality assurance framework and customer satisfaction surveys that allow us to respond to issues in respect of the quality service we deliver.

Beyond operational matters, we have risk groups for ‘external influence and impact’ and ‘organisational capability’. The strategic risks in these groups impact operational delivery. In particular, the risk that the *Modernising LeO* programme does not deliver the intended benefits to time, cost or quality would significantly impact our operational performance.

We are mitigating this through proportionate and effective programme governance and management. We have created a modest additional budget to cover some temporary roles to help deliver the programme and some additional back-fill resource to cover the work of the operational staff helping deliver the programme. And we have a robust communications and engagement plan to ensure staff have a good understanding of the drivers of change, the changes being introduced and the benefits they will bring, and that any structural changes are handled sensitively, effectively and with minimum disruption.

We are accepting a higher degree of risk than usual during 2017/18 in order to make the changes the organisation requires to deliver sustainable improvement. The changes will help us deliver improved performance over time, prepare us to manage the loss of the CMC jurisdiction with minimum disruption and will help us deliver the efficiencies required by MoJ by 2019/20. We accept the risks of driving so much change across the organisation and believe the risk of proceeding more slowly or with less ambition to be greater than a concerted effort to transform the organisation at pace.

9 Other assumptions

9.1 VAT

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

9.2 Pay Policy & Revalorisation:

An average of 1% has been budgeted for revalorisation from April 2017 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, take up stands at approximately 92% of all employees. An average Employer's Pension contribution assumption of 7.4% for existing and 10% for new staff has been used for 2017/18 which reflects current pension costs to the organisation, which are lower than they would be were staff able to join the Civil Service Pension Scheme***.***

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.

9.3 Efficiency / Performance

During 2016/17, our expectations in respect of our performance have been impacted by the significant workloads at key stages of the investigation process. As a result a number of initiatives have been implemented during quarter 2 and 3 in order to deliver incremental improvements in performance, particularly in respect of timeliness, quality and cost.

These targeted initiatives feed in to our *Modernising LeO* Programme. This focusses on delivering a unified IT environment, including a new Case Management System, together with a new business process and flexible staffing model and will ensure that we are recognised as a well-run public service that delivers value for money.

The change initiatives and *Modernising LeO* Programme will not deliver cashable efficiencies within 2017/18 and therefore we will continue to manage investigator performance in respect of the throughput of cases and effective progression. In addition, we are in the process of developing a revised Balanced Scorecard that measures performance across 4 quadrants:

- customer experience and quality;
- raising professional standards;
- efficiency and resilience; and
- people, leadership and culture.

It is the intention to continue measuring performance against our existing KPIs during 2017/18, however, we also intend to introduce additional measures based on the Balanced Scorecard that will provide a more rounded performance overview that aligns with the new strategy.

10 Capital Expenditure & Cash flow

10.1 Capital Expenditure Capital Expenditure

Anticipated Capital expenditure	**£'m**
Case Management system	0.31
Infrastructure	0.10
Desktop hardware	0.03
Website	0.05
Total	0.49

Case management system
Legal Ombudsman's Case Management System is critical to its operation. The Case Management System delivered at the end of 2014 is no longer considered to be fit for purpose and therefore the process of replacing the system began in 2016/17 with a spend of £195k with the remainder of the project costs in 2017/18. The project is progressing well.

Infrastructure
The incumbent infrastructure managed service provider's contract expires at the end of June 2017. We are well advanced in procuring a replacement and are about, to enter a period of dialogue with the preferred supplier about how to repair and replace infrastructure services that have not performed well. Any spend could be capital or revenue but prior to discussions with the new supplier the split is an unknown entity that will depend on the eventual scope of services. A prudent capital budget has been sought to cover costs associated with infrastructure transition.

In addition, we will be re-procuring our telephony provision in the first half of 2017/18. We had intended to bundle telephony with IT infrastructure but were advised against this by MoJ. As a result we will begin the re-procurement once we have worked with the new infrastructure to specify the telephony requirements so that they better integrate with our new IT infrastructure. There may be modest capital costs associated with this process, which would be funded from this budget.

End user devices

Budget was approved 2016/17 and a project commenced for the refresh of the end user devices during that financial year. In order to avoid this situation arising in the future LeO has put in place a rolling programme to refresh its hardware.

Website

LeO's website needs to be moved to a more robust hosting location to prevent loss of service to the public and to ensure stability. LeO has ambitions to make more effective use of its website and this is currently not possible under the current set-up. The first phase of developing the website, as part of the *Modernising LeO* programme, is to move to a more robust and stable environment. In the second phase of the programme we intend to explore more radical changes using web-based technology to facilitate a wider range of channels through which our customers can engage with our service, such as portals.

10.2 Cashflow

We anticipate a cash balance at the end of 2016/17 of c. £17.5m after receipt of £9.7 million levy funding approved regulators in respect of 2016/17 of and £1.5m Grant in Aid of in respect of CMC activities. For 2017/18 we forecast expenditure before depreciation and amortisation for our Legal activities of £11.1 million. We anticipate case fee cash collections of £1m and Capital expenditure of £0.49m and hence a cash requirement of just over £10.6 million. We therefore anticipate a cash balance at the end of 2017/18, 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 2017/18.

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

We ask the Legal Services Board is requested to approve the proposed capital and revenue budget for 2017/18.