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| To: | Legal Services Board | |
| Date of Meeting: | 28 March 2011 | Item: Paper (11) 23 |

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| Title: | Office for Legal Complaints (OLC) Budget 2011/12 | |
| Presented by: | Julie Myers, Corporate Director julie.myers@legalservicesboard.org.uk / 020 7271 0059 | |
| Author: | Julie Myers, Corporate Director Edwin Josephs, Director of Finance and Services | |
| Status: | Restricted | |

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| Summary: |
| <p>The Legal Services Act 2007 describes a number of formal points of interaction between the LSB and the OLC. One of these is before the Board today: submission of the OLC's budget for financial year 2011/12 for LSB approval.</p> <p>The proposal is for a total budget of £19,720,000. The OLC agreed this budget for submission to the LSB at its meeting on 21 February 2011. The full proposal is attached at Annex A.</p> <p>In line with the agreed mode of working between LSB and OLC, rather than conduct a de novo analysis, the Board should approve the budget if it has adequate assurance that the OLC Board considered all appropriate aspects in recommending the proposed budget. To assist with this, we provided OLC with a suite of criteria to address in its budget submission to support the LSB approval process. The OLC has confirmed that the submission attached at Annex A meets these criteria.</p> <p>In reviewing the budget, we have received further clarification from OLC on some aspects and have asked that an updated summary budget be tabled at the 28 March meeting.</p> <p>The Executive's recommendation is to accept the proposal subject to one condition. Adam Sampson (Chief Ombudsman) will attend the meeting to answer questions on this item.</p> |

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| Risks and mitigations | |
| Financial: | OLC has its own Accounting Officer. |
| FoIA: | TBC. |
| Legal: | N/A. |
| Reputational: | Successful establishment of the OLC and Ombudsman scheme is also an indicator of LSB's own success. |
| Resource: | N/A. |

| Consultation | Yes | No | Who / why? |
|------------------------|-----|----|---|
| Board Members: | ✓ | | LSB CEO has discussed requirements for resource flexibility with OLC CEO Steve Green and Bill Moyes provided initial comments on the submission. |
| Consumer Panel: | | ✓ | |

Others:

MoJ comments were sought by the LSB and these are included in the paper.

Recommendation(s):

The Board is invited to note and to approve the OLC's budget for 2011/12, subject to one condition (see paras 20 and 24, below).

LEGAL SERVICES BOARD

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OLC Budget 2011/12

Executive Summary

Recommendation(s)

The Board is invited to note and to approve the OLC's budget for 2011/12, subject to one condition (see paras 20 and 24, below).

Background / context

1. Part 6 and Schedule 15 of the Legal Services Act 2007 (**the Act**) describe the arrangements for the handling of complaints about legal services professionals and provide the framework for the relationships between LSB and OLC. Whilst the Ministry of Justice (**MoJ**) is the sponsor department for the OLC (as it is for the LSB), parliamentary, financial and performance accountability is shared with the LSB. For instance:
 - the OLC gives its annual report to the LSB which in turn presents it to the Lord Chancellor for presenting to Parliament
 - the LSB must approve the OLC's budget
 - the LSB can set or require setting of performance targets for the OLC.
2. Like the LSB, the OLC is required, so far as is reasonably practicable, to act in a way which is compatible with the regulatory objectives and which it considers most appropriate for the purpose of meeting those objectives. It must also have regard to any principles appearing to it to represent the best practice of those who administer ombudsman schemes. On the latter, the Legal Ombudsman scheme has been admitted as a full voting member of the British and Irish Ombudsman Association (**BIOA**).
3. Whilst the LSB has a statutory responsibility to approve the OLC's budget, it made clear in 2010/11 that it does not want to duplicate the work properly done by the OLC Board in scrutinising the basis on which the budget has been developed. As such, an approval process was designed to provide adequate assurance to the Board about the robustness of the OLC process rather than seeing the LSB conduct a de novo analysis. To assist with this, the Board provided OLC with a suite of criteria to address in its budget submission. The OLC has confirmed that the submission at **Annex A** meets these criteria.

Statutory requirements

4. Section 23 of Schedule 15 of the Act concerns the OLC's budget and states:
 - (1) *The OLC must, before the start of each financial year, adopt an annual budget which has been approved by the Board (LSB).*

- (2) *The OLC may, with the approval of the Board, vary the budget for a financial year at any time after its adoption.*
- (3) *The annual budget must include an indication of –*
- a. *The distribution of resources deployed in the operation of the ombudsman scheme, and*
 - b. *The amounts of income of the OLC arising or expected to arise from the operation of the scheme.*
5. The Act also prohibits the OLC from borrowing money without the consent of the LSB (or in accordance with a general authorisation given by the Board) and requires the OLC to give the LSB its statement of accounts for presenting to the Lord Chancellor and Comptroller and Auditor General on its behalf.
6. As an independent NDPB, the OLC also has its own Accounting Officer, Adam Sampson, and Audit and Risk Committee. It has also its own independent sponsor-body/sponsor relationship with the MoJ in accordance with Managing Public Money. Hence, while the LSB approves the *level* of the budget, we do not have any responsibility in relation to in-year financial control issues (unless these cause the budget to be varied) nor in relation to the propriety of spend.

Criteria to be addressed by OLC in budget submission to LSB for 2011/12

7. The LSB requested that the OLC address the following areas in its submission:
- 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.
 - A summary of where the Plan and budget has changed in response to stakeholder responses which should explicitly include the outcome of discussions with MoJ and the extent to which the final Plan and budget takes account of their input.
 - A summary of the key risks to delivering the Plan for 2011/12 and mitigation proposed.
 - We also requested “the volumes predicted for the year along with a sensitivity analysis illustrating your response should volumes fluctuate +/- 25%” but acknowledged in the joint LSB/OLC Board meeting in December that an alternative approach may suit OLC more. OLC confirmed that we would be sent the sensitivity analysis subsequently used by the OLC Board in reaching their conclusions on budget.

Review of assurances provided by OLC Board

A. 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

8. Annex A contains the OLC’s formal submission:
- Page 2 lists a summary budget including **amounts of income** expected to arise from the scheme. The OLC shows three income streams: levy; case fee income; other income (ie amount generated by performance of Legal

Services Ombudsman function until closedown).

- The **case fee** income forecast is not explained explicitly in this submission but consultation around the levy established the principle that, during the initial two-year period, up to 10% of OLC's total operational costs may be funded via case fees.
- The **other** income of £281k represents the monies that the OLC will receive for performing the function of the Legal Services Ombudsman until the function ceases to exist (expected to be autumn 2011). MoJ commented that this figure was somewhat lower than that anticipated in a MoU agreed between OLC and MoJ. OLC has subsequently advised that: *"When the Budget was set it was anticipated that the OLSO work would have been initiated in February and March. Therefore, the budget assumed that a significant proportion of the OLSO costs would be incurred in 2010-11 and the Budget for 2011-12 included only the 2011-12 proportion of the total MOU budget for OLSO work. The impact of this is that both the costs and income for OLSO work will be higher than set in the Budget at the end of January. However, because all OLSO costs incurred will be matched by OLSO income the net position is neutral overall."*
- The summary budget on page 2 also illustrates how expenditure is distributed across the OLC operation. This is supplemented by a pie chart on page 10, which shows more clearly how expenditure is allocated across cost centres.

B. Changes to Plan and budget in response to stakeholder responses explicitly including the outcome of discussions with MoJ and extent to which the final Plan and budget takes account of their input

9. OLC has advised that it received two responses to its draft Plan and budget and that neither necessitated material change. Any changes that there are to the Plan are due to the refinement of planning assumptions over the last four months not feedback from consultation. As at time of drafting, we have not received the final Plan.
10. The submission did not include any comments from MoJ. As this was an explicit requirement, we asked MoJ directly for its views and these are included as appropriate across this paper. MoJ also made a small number of general points:
 - They noted that OLC had not sought MoJ views because OLC is required formally to seek approval from LSB for its budget. Nevertheless MoJ asked that its views be sought by LSB in future years to ensure that it is properly recorded in "public accounts arenas". LSB response – we will continue to do so.
 - They suggested we review the timing of budget approval noting that MoJ would require pre-Christmas indication of budget indicators in future years. LSB response – we will discuss the implications of this with MoJ and OLC.

- They queried how (or if) LSB was intending to monitor the budget once approved. Response – we were surprised by this question as all of our discussions with MoJ to date around OLC oversight have been on the basis that ongoing financial performance review was the rightful role of MoJ as sponsor department, particularly as OLC has its own Accounting Officer. MoJ has clarified that, whilst it does not want to subject OLC to duplicative financial oversight, it believed that it would be odd if financial risks and implications of OLC operations were not considered as part of LSB’s performance oversight of OLC.
- As regards cash flow (page 12 of the submission), MoJ states that it is aware of the cash requirement from MoJ, and likely capital expenditure, and that it is consistent with MoJ expectations.

C. Summary of the key risks to delivering the Plan for 2011/12 and mitigation proposed

11. Page 5 of the submission lists the key challenges to the LeO scheme over the 2011/12 period but does not describe the mitigation. In asking this question, we wanted specifically to understand the key financial risks faced by the OLC rather than the broader range of reputational risks. From the list provided these would seem to be:

- Case fee collection – lawyers don’t pay. This would present an immediate cash flow risk. OLC would need to consider whether it wished to take direct action to recover any debt or leave the issue to be resolved via regulatory intervention.
- First judicial review. Our view is that costs would need to be very high indeed to present a material risk to the budget.
- Investigator efficiency not as high as planned leading to the need to recruit additional investigators to prevent case backlog.
- Call and case volumes exceed planned levels leading to need to increase headcount.

12. The submission states that current activity levels lead OLC to believe that the threat to the budget from the **last two risks** is low. Anecdotally we understand activity levels are running some way below forecast and rather less than past activity lessons for the Legal Complaints Service. There is no assessment of the likelihood of the first two risks within the submission.

D. Sensitivity analysis used to determine budget assumptions

13. Section 2 (page 3 – 5) of the submission outlines the OLC’s key sensitivities and efficiency assumptions. Their analysis suggests that a +/- 25% change in call volume / caseload demand would result in a +/- £2.5 million cost increase or reduction (12.5% of budgeted expenditure) based on assessments of annual case capacity and investigator efficiency.

14. OLC has separately started a strand of discussion with both LSB and MoJ about how any request for in-year budgetary increase to respond to a spike in demand would be handled. The aim is to find a mechanism whereby our statutory duty to consider any in-year budgetary variation, and MoJ's need to consider waiving the public sector recruitment freeze, can be met in the most expeditious way allowing resources to be deployed promptly after a spike. (This is for situations that cannot be managed via short-term contingency measures.)
15. MoJ commented that its main concern about the OLC is demand risk.

Additional observations

16. **Magnitude of budget** – The proposed budget of £19.720M is broadly in line with the £19.799M annual operating budget predicted in the OLC's inaugural Business Plan.
17. **Pay progression and revalorisation** – The budget submission at page 8 includes discussion of the OLC's proposals as regards the pay bill for 2011/12. It states that an average of 3% has been budgeted for revalorisation and progression. We have investigated this aspect of the budget carefully, bearing in mind the need to ensure that the Board does not inadvertently approve a budget which includes pay bill proposals that are not compliant with public sector pay controls (including the prevailing two-year public sector pay freeze).
18. OLC provided the additional information stating: *“The Legal Ombudsman pay structures and staff have been recruited on the basis of a stepped progression model. Progression is therefore a key requirement of the pay structures and, notwithstanding cabinet office guidelines around revalorisation, progression remains a key requirement in the OLC organisational design. A paybill increase assumption is required in the budget to enable this progression, and has been modelled to reflect the anticipated levels of progression over 2011/12.”*
19. They subsequently provided the following additional assurance: *“we have fully involved the MoJ in the design of our pay policy as we understand our obligations towards public sector pay controls. However, we expect that the stepped progression model will be compliant with the controls. Our Memorandum of Understanding with the MoJ makes clear our responsibilities in this area. We are in the process of agreeing our 2011/12 pay remit with the MoJ in line with these. The budget reflects our best assumptions on the outcome of these discussions.”*
20. For their part, MoJ states: *“pay progression and revalorisation are covered by the pay remit process and this requires MoJ (or HMT) approval. OLC's response is consistent with that and it is in progress.”* In conversation, MoJ advised that a meeting was due to be held with MoJ HR on Monday 28 March to discuss the OLC pay remit for 2011/12. At this stage, they could not confirm whether a 3% proposal would be acceptable. **They recommended that LSB may therefore wish to caveat its budget approval pending completion of the pay remit process and the budget be re-submitted by OLC once the pay remit is agreed, i.e. as an in-year budget variation.**

21. **Budgeted rate of National Insurance (NI)** – the submission states that Employers' NI has been budgeted for based on the current rate of 12.8%. In fact, the rate increases to 13.8% in 2011/12. OLC acknowledge this, commenting that the Lower Earnings Limit for NI in 2011/12 has also been raised from £110 to £136 per month which applies to Employers as well as Employees' NI. Having factored both changes into the budget model, they state that the impact of the 1% rise in NI from 12.8% to 13.8%, combined with the increased LEL, results in a total cost increase of +£22k. On the proposed £19.7M budget this represents a 0.1% increase in the paybill.
22. Whilst the figure of £22k for increased NI appears somewhat low on a pay budget of £12.8m, we do not have access to the OLC's model and thus do not know what assumptions are included in its pay budget calculations.
23. **Contingency** – the Board will note a figure of £180k (or a little less than 1%) for contingency.

Recommendation

24. Based on the scrutiny undertaken by the OLC Board in developing the budget and the assurances provided in response to the Board's criteria for submission, the Executive recommends that the budget should be approved, subject to an agreement that a varied budget be re-submitted if the pay remit for 2011/12 is a figure different to 3% .
25. The Board is invited to note and to approve the OLC's budget for 2011/12, subject to one condition (see paras 20 and 24, above).

25.03.11