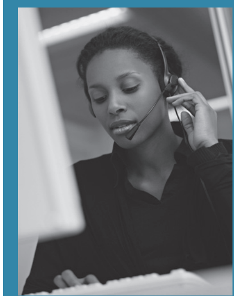
Supporting members

Defending services

Branch guide to council finances and privatisation



UNISON
Local Government

Introduction

This guide looks at how branches should examine council finances when faced with privatisation proposals.

In the current climate many privatisation proposals are 'finance driven' because of cuts to council funding. Branches will usually be faced with a scenario where the Medium or Long Term Financial Plan is forecasting either that significant 'savings' are needed relative to the overall budget or that income is falling while expenditure is rising. For example, Edinburgh councillors received a report on the Long Term Financial Plan on 27 June 2009 that forecasted a gap between income and expenditure that widened year on year.

- £39.7m in 2010/11rising to
- £86.3m in 2012/13 and to
- £247m by the end of the 10 year period

Recently, long term future financial projections have been presented graphically and the term 'graph of doom' or 'jaws of doom' has been a common description. These graphs attempt to either show a widening gap between expenditure and income or to suggest that in the future there will be no resources available for services other than adult and children's services. This future financial scenario then forms the pretext or reason for the 'large scale' privatisation proposal.

This guide covers:

1. The starting point - understanding the financial assumptions
2. The importance of a Plan B
3. Scrutinising the options appraisal
4. Scrutinising the outline and final business cases
5. Case study

1 Starting point – understanding the financial assumptions

As a starting point branches will need to ensure that they understand:

- how the Medium or Long Term Financial Plan has been constructed
- the assumptions behind each forecast of income reduction and expenditure growth
- the extent to which they might vary,depending on how circumstances change.

Branch actions

Here are some examples of actions branches can take:

1.1 On the income side, ask what assumptions the council has made about future income, including grants from central government, business rate income, fees and charges and council tax increases.

1.2 On the expenditure side, ask what assumptions the council has made about expenditure growth - including future pay increases and pension contributions, inflation, contributions to and from reserves, the need for contingencies and future budget pressures.

1.3 Understanding these assumptions is vital background to understanding the financial challenges that councillors are being told they face. But it also provides opportunities to question and challenge. For example:

- if no assumptions are being made about future income growth from the New Homes Bonus, you could argue that they should be
- if the projections for the costs of capital financing are increasing significantly - both in cash terms and as a proportion of the overall budget - then the capital programme is 'squeezing' the revenue budget. There is then a debate to be had about whether the size of the future capital programme is appropriate given the revenue consequences
- if budget pressures are presented as big numbers with lots of zeros after them, they are likely to be unquantified. UNISON branches should ask exactly how the figure has been arrived at

1.4 If your council is relying on a 'graph of doom' or a 'jaws of doom' scenario, it is essential that you have a clear understanding of the assumptions that lie behind the calculations about future income, population growth and population structure. For example, some councils forecast expenditure growth from population increase but they do not add in any income growth from the additional council tax that will be paid by this additional population.

2 The importance of a Plan B

While that analysis is critical to understanding the basis on which projections are being made and where there may be scope for discussion, a financial gap is still likely to exist and will need to be addressed. If council officers and councillors do not see that an alternative is possible, then they may pursue the ‘privatisation route’ by default. It is therefore critical that branches and regional organisers carry out the analysis above.

Branch actions

As part of the process UNISON branches will need to:

2.1 acknowledge that the council faces financial challenges

2.2 argue that ‘status quo’ is not an option

2.3 argue that there is a growing body of evidence that shows that councils can change service delivery and reduce expenditure by looking at all the resources and inputs to service delivery and developing service improvement plans that may result in different ways of a service being delivered

2.4 argue that a council developing a service improvement approach with its workforce and service users is more likely to produce better outcomes for the public, for its staff, for accountability and the finances. This is because it is limiting the scope of flexibility over future budget decisions if it removes its ability to influence a significant part of its budget by making medium to long term contractual commitments to a private company

2.5 secure agreement from the council that any procurement process that does go forward will require the development of a public sector comparator

(For more information see UNISON’s branch guide to securing in-house services)

3 Scrutinising the Options Appraisal

The options appraisal process should include the financial analysis of the options that have been considered. It is important for branches to ensure that they are supplied with a copy of the financial analysis that underpins the council's options appraisal and the assumptions on which it is based.

For more information see UNISON branch guide to options appraisals.

4 Scrutinising the Outline and Final Business Cases

The outline and final business cases will include the proposed changes to the delivery of the service, together with the financial assumptions on which those proposals have been constructed.

These will include assumptions about income. For example the income stream of payments from the council, fees and charges that may be applied and additional income that may be earned from external purchasers.

They will also include assumptions about expenditure, such as the number and location of employees, future pay increases, pension contributions, premises and equipment costs and contractors' fees for providing the service. These fees will incorporate the profit element and the interest charged on any capital investment.

Understanding the financial assumptions that have been used to construct the business plan can be critical to demonstrating that a privatisation proposal is not viable, or is based on flawed assumptions, or that it carries an unrealistic risk either to the local authority, the new organisation or the affected employees. It will also help to explain the consequences for UNISON members.

It will be essential for branches to get a copy of both the outline and final business cases.

5 Case study: Barnet social care trading company – the finances unravel

This case study looks at a proposal for turning Barnet's adult social care services into a subsidiary of a local authority trading company. It shows how the financial case for the company and the council was initially constructed and then amended substantially. It looks at the questions that this gave rise to and how the initial assumptions have failed to materialise. It also shows the damaging consequences of these flawed financial assumptions for Barnet council, its staff and service users.

The context

Branches need to understand the drivers behind any privatisation proposal. In this case study there were multiple drivers:

- Reduced financial resources
- Budget pressures arising from growth in the number of elderly people needing care
- Policy objectives to shift service provision from care providers to direct payments and personal budgets, driven by the 'choice' agenda and assumptions that a shift to personal budgets would reduce costs and increase budgetary control
- Avoidance of redundancy costs

The proposal

May 2011

In order to respond to these drivers, Barnet council decided to explore a proposal to establish a Local Authority Trading Company (LATC) which would provide adult social care services.

The structure proposed by Barnet is different to those developed elsewhere. The model involves a main holding company with subsidiaries:

"Set up a holding company in the form of a Local Authority Trading Company, of which Barnet Homes (an ALMO) would be a subsidiary;

- *Set up a subsidiary Local Authority Trading Company for the management of those Adult Social Services (Your Choice Barnet) currently provided in-house; and*
- *Transfer the adult social care service provision from the management of the Council to the Local Authority Trading Company following approval of the business plan"*

The council argues that providing services in this way will:

- Enable savings to be achieved
- Generate income by providing additional, charged-for services that fee paying clients would choose to purchase or by selling the services to clients who do not live in Barnet

This model immediately raises a number of issues as to:

- How and where savings are to be achieved – staffing levels, pay, terms and conditions of staff, overheads and accommodation costs
- The additional costs associated with a) new governance arrangements b) client management costs c) the VAT liability of the LATC d) the impact on the local authority's VAT exemption and potentially e) a Corporation Tax liability
- The extent to which people given personal budgets decide to spend those budgets on services provided by the LATC

Equally important are the assumptions about the demand for a) charged-for services from fee paying clients and b) the demand for services from non-Barnet clients.

Financial forecast

Table 1 below shows the projected financial forecast presented to the Cabinet Resources Committee on 24 May 2011.

Table 1

	Year 1	Year 2	Year 3	Year 4	Change Year 1 to Year 4
	£	£	£	£	£
Gross Spend	6270562	6222663	6190651	6190651	-79911
Income	6421768	6608022	6730782	6767262	345494
Operating Profit	151206	385359	540131	576611	425405
Add irrecoverable VAT on trading	265000	265000	265000	265000	0
Add VAT on support services	79666	79666	79666	79666	0
Group and Board arrangement costs	88800	88800	88800	88800	0
Net profit (loss) before tax	-282260	-48107	106665	143145	425405
Corporation Tax	0	0	0	0	0
Net profit(loss) after tax	-282260	-48107	106665	143145	425405
Cumulative profit (loss)	-282260	-330367	-223702	-80557	

Observations

- The model shows an operating profit in each year
- But the model creates additional VAT costs of £344,666 that did not exist beforehand
- The model creates additional Group and Board arrangement costs that did not exist beforehand
- The model carries a Corporation Tax risk of up to £187,000 that did not exist previously
- Therefore the combined effect of 'savings' on Gross Spend and income growth need to reach at least £433,466 (£344,666 + £88,800) for the 'model' to be potentially viable (before Corporation Tax considerations)
- Key questions: How realistic is income growth of £345,494 over a 4 year period? How many additional clients are required? What shift from non-fee paying to fee paying clients is assumed? The subsequent high level business plan report published in January 2012 revealed that this was a critical factor as there was an ...

  "…expectation that the LATC will generate business from a wider group of services users including other local authority areas, self-funders, and other vulnerable people. This proportion grows over the four years from 3% to 9% of target income. The LATC could also gain new business from existing adult social care service users, whose needs have previously been met by other external providers"

- The model assumes that gross spend reduces while income increases. This is counter-intuitive as staffing costs are likely to rise if the number of clients increases. This might be possible if there is a shift from non fee paying to fee paying clients but this assumption is not stated
- The proposals introduce a potential Corporation Tax liability for Barnet Homes estimated at £187,000

  Risk: *There is a risk that setting up an LATC which incorporates Barnet Homes will affect the tax exemption status of the existing Arms Length Management Organisation (ALMO). This could result in Barnet Homes becoming liable for Corporation Tax. The potential liability would have been £187k for 09/10 as stated in Barnet Homes accounts. This figure is the tax which Barnet Homes were not liable to pay in 09/10 by way of the tax exemption in respect of their activities with the Council.*

- The financial assumptions envisage losses in the first two years. In order to provide counter arguments, the reports to Councillors introduce the concept of 'double funding' (see below)

It was critical to understand the specific business plan assumptions that lie behind the financial projections:

- The number of fee paying and non fee paying clients
- The projected use of LATC services by people given personal budgets
- The numbers of additional clients that are and are not Barnet residents
- The staffing implications that flow from those assumptions

This information was not placed in the public domain, nor was it shared with the trade unions recognised for collective bargaining purposes, despite the fact that those assumptions were critical.

What did UNISON argue?

UNISON argued that the failure to disclose the financial analysis means that all the components of a financial case – budget forecasts, capital and revenue forecasts, user charges, income and expenditure, affordability based on whole life costs and contingency plans for cost overruns/liabilities – could not be publicly verified.

Operating profit

The assumptions about the elements of the operating profit are shown in table 2 below.

Table 2

Elements of Operating Profit	Year 1	Year 2	Year 3	Year 4
	£	£	£	£
Agatha House	-55704	-39817	-39817	-39817
Flower Lane Autism Service	188828	188828	188828	188828
The Space	83470	169750	256030	256030
Rosa Morrison	37167	137167	137167	137167
Barnet Supported Living Service	-268315	-181583	-113091	-76611
Valley Way	31320	31320	31320	31320
Community Support Team	31709	31709	31709	31709
Barnet Independent Living Services	2732	47986	47986	47986
Operating Profit	151207	385360	540132	576612

Observations

The 'operating profit' is shown to grow by £425,405. The key elements are

- Reducing the cost of the Barnet Supported Living Service from £268,315 to £76,611
- Increasing the surplus from The Space from £83,470 to £256,030
- Reducing the cost of Agatha House from £55,704 to £39,817
- Increasing the surplus from Barnet Independent Living from £2,732 to £47,986

Financial impact for Barnet Council

A separate financial analysis is provided in relation to the cost implications for Barnet Council. Table 3 below presented to Councillors.

Table 3

Cost implications for London Borough of Barnet	Year 1	Year 2	Year 3	Year 4
SAVINGS	£	£	£	£
Cost reduction	119554	67453	199465	199465
Exit income increase	97573	203210	354347	484052
TOTAL SAVINGS	217127	370663	553812	683517
GROWTH	£	£	£	£
VAT on trading	344666	344666	344666	344666
Retained client	63901	63901	63901	63901
TOTAL GROWTH	408567	408567	408567	408567
Net position for London Borough of Barnet (Savings - growth)	-191440	-37904	145245	274950

Observations

- The cost reductions relate to costs that Barnet Council no longer incurs or to costs that Barnet Council currently incurs and will be met by the LATC in future:

  "There have been some assumptions built into the financial model, including that: VAT will be payable on all non-employee expenditure; support staff will be employed by Barnet Homes; 20% of Chief Executive and Finance Director roles, plus costs for the running of the Board will be recharged to LATC; a 1% assumption for core costs."

- The 'Exit income increase' is not explained but is assumed to be either from services bought by the LATC from Barnet Council or the additional income generated following transfer ofthe service to the LATC – but this does not appear to correlate with the income growth shown in the financial model for the LATC

- The VAT cost of £344,666 is significant

- The cost of the retained client remains with Barnet Council

Double funding

Barnet Council's papers (table 4 below) shows that the idea of 'double funding' was presented to councillors as an important consideration. The papers raise the spectre of an in-house service that is increasingly not used as people shift to direct payments:

"The potential for double funding through meeting the fixed costs of the inhouse service provision whilst also committing to provide funding via direct payments that are subsequently spent elsewhere. This makes the services unviable on the grounds of cost.

A reduction in the number of people accessing the services, will in turn, have an impact on the quality of the service being provided. Unjustifiable costs can lead to: necessary redundancies or staff choosing to leave for other roles; declining support and staff morale; both impacting on the quality of service received. Undermining choice for people with direct payments, who cannot continue to access the range of high quality specialist services that are currently provided in-house.

Whilst the proposed LATC is not likely to achieve cumulative profitability in its first four years of operation, the business case model predicts cost avoidance of circa £3.8m in double funding costs as a result of the roll out of the personalisation agenda."

Comment:
The papers presented to councillors failed to explain why Barnet Council could not manage this change and avoid unnecessary expenditure that reaches £1,586,658 per annum in year four.

Table 4

	Year 1 £	Year 2 £	Year 3 £	Year 4 £
Double funding costs as a consequence of the roll out of personalisation agenda	353,544	755,837	1,088,464	1,586,658
Cumulative double funding costs as a consequence of the roll out of personalisation agenda	353,544	1,109,381	2,197,845	3,784,503

Risk management failure

The risk of commercial failure was identified in the 24 May 2011 report:

"RISK MANAGEMENT ISSUES

Risk: *Commercial risk such as venture failure and financial loss ultimately resides with the council.*

Planned Mitigation: *This risk will be covered in the business plan which will model several scenarios and flexibility for potential service modification in response to market conditions. Barnet Homes will be represented on the project board to share their learning and feed into the Business Plan. The full Business Plan will be presented to this committee for approval upon completion of the transition phase."*

Fast forward to January 2012

Less than a month before the new arrangements were due to be established, a new financial model was published that had significant differences to the plan considered in May 2011. Instead of projecting losses in years 1 and 2 followed by surpluses in years 3 and 4, the new model (table 5 below) now projected surpluses each year.

Table 5

Your Choice Barnet Limited	Year 1	Year 2	Year 3	Year 4
	£	£	£	£
Original net profit (loss) before tax	-282260	-48107	106665	143145
Irrecoverable VAT on trading reduction	231700	231700	231700	231700
VAT on support services reduction	71036	71036	71036	71036
Group cost adjustments	800	800	800	800
Additional Direct Costs*	-157000	-168500	-197500	-212000
Buidings Contract Budget (Council retained)	294000	294000	294000	294000
Transport Budget (Council retained)	537644	537644	37644	537644
Overheads not previously charged to ASCH**	-55655	-55655	-55655	-55655
Reduction in income	-817168	-648974	-532554	-569034
LD income omitted from model	262242	262242	62242	262242
Net change	367599	524293	611713	560733
Revised net profit(loss) before tax	85339	476186	18378	703878

Observations

- £302,736 of the £344,466 potential VAT liability is removed
- Group costs are reduced by £800
- £262,242 income from Learning Disability had not been included and now is
- £831,644 of expenditure relating to the Buildings Contract and Transport budgets that are retained by the Council is removed from the expenditure
- Income is reduced by £817,168 in Year 1 falling to a reduction of £569,034 in Year 4
- Additional costs* and overheads** of £212,655 are added in year 1 rising to £267,655 in year 4

The model now looks financially attractive as the LATC is projected to generate a surplus each year.

Barnet Council finances

The original assumptions identified a net cost to Barnet Council in years 1 and 2, with savings accruing to the council in years 3 and 4. The revised position looks like this as shown in table 6 below:

Table 6

	2012/13	2013/14	2014/15	2015/16
ORIGINAL				
Net position for London Borough of Barnet	**-191440**	**-37904**	145245	274950
Available Purchasing Budget for Services purchased through LATC	5808566	5993594	6236457	6480160
Payments to LATC	5223837	5578285	5817465	5817465
LD payments	262242	262242	262242	262242
Transport retained budget	537644	537644	537644	537644
Buildings contract	294000	294000	294000	294000
Recharges sold to LATC	-150000	-150000	-150000	-150000
Reduction in Council Support Service Budget	-70000	-70000	-70000	-70000
LATC profit	-85339	-476186	-718378	-703878
Total	6012384	5975985	5972973	5987473
REVISED				
Net position for London Borough of Barnet	**-203818**	17609	263484	492687

Observations

- Payments to LATC grow by £593,628 over the 4-year period
- £150,000 of corporate recharges appear to be met by the LATC but this sum is not separately identified in the LATC profit and loss figures
- The LATC profit is paid as a dividend straight back to the Council
- The net position shows a worse position in year 1, but an improved position in Year 2, 3 and 4
- However this is partly due to the £70,000 reduction in the Council Support Service Budget. It is not clear whether these costs transfer to another council budget
- The use of the payment of the profit as a dividend to the council means that the minimum profit required to arrive at a break-even position for Barnet

> Council is over £400,000 in years 2 and 3 and over £200,000 in Year 4.

Your Choice Barnet starts up... and quickly runs into difficulties

Your Choice Barnet (YCB) was established in February 2012. On 1 March 2013 the company issued a 90-day redundancy notice and consultation period.

YCB is now projecting a loss of £60,000 in 2012/13 compared to the projected surplus of £85,000 that was contained in its January 2012 high level business plan. What's more, the redundancy consultation document says that a key operational change is about to create a budget gap of £1 million.

> *"Your Choice Barnet are currently projecting a loss for 2012-13 of approximately £60,000.*
>
> *If no changes are made with regard to efficiencies, the change from a block contract to payment-by-actual would create a gap of approximately £1m.*
>
> *This does not necessarily mean that people have stopped using the service, but rather that the arrangements for the block contract did not accurately reflect day to day usage, meaning that the Council has paid above the market rate in Year One."*

This change to the payment mechanism is precisely the issue that UNISON had warned would create financial insecurity back in January 2012:

> *"Financial issues and payment mechanism: The funding of Adult services will be insecure. The Council plans to fund Your Choice Barnet via a block contract arrangement, paid monthly in advance. But this is for only one year. In year two, a volume and cost model will come into effect with Your Choice Barnet invoicing the Council for the actual delivery of services with payments made in arrears.*
>
> *The business plan anticipates there 'should' be an uptake in Direct Payments as a result of national and local drivers after year one. By the third year, the '…volume and cost model should be fully established and the council will not provide a guarantee of minimum financial investment for Your Choice Barnet' (page 63) This means:*
>
> - *Adult Services are being required to transfer to a new payment mechanism within a very short period of time, which is dependent on changes in the uptake of Direct Payments.*
> - *The transition period is far too short and reliant on events that are outside the control of Adult Services.*
> - *The proposal to review the situation '…as it is better understood' (page 63) is totally inadequate."*[1]

The March 2013 redundancy consultation goes on to state that £179,000 of 'efficiencies' have been achieved but...

> *"These efficiencies have not however achieved the level of savings required to ensure financial viability and operate the business."*

More importantly, it appears that a significant feature of the Business Model assumed that

1 European Services Strategy Unit, The Barnet Group Ltd: Local Authority Trading Company: Privatising Adults and Housing Services, January 2012

the organisation would grow as it attracted new business from Barnet self-funding residents not eligible for support from the council and from people living outside Barnet who would be fee paying.

The next statement calls into question the reliability of the 'market research' that informed the Business Plan:

> *"A key area of the original Business Plan for YCB was to win new business, in Barnet and beyond, and bring growth to the organisation. Our current structure, pay and benefits mean that the fees required to be charged for services make it less competitive to sustain the business or win new business against our competitors who have lower costs."*

What is now being proposed?

The following extracts from the proposals put to the trade unions illustrate how drastic the potential consequences for staff and service users will be.

Service reductions

> *"Waking Night Staff*
>
> *In Valley Way there have traditionally been two waking night staff on duty each night (Valley Way is a six-bed residential respite service which is registered with CQC), however following monitoring of service users and their night-time needs, it is clear that support can be safely provided by one person."*

Re-organisation and de-skilling: Assistant Support Workers instead of Support Workers

> *"It is proposed to reduce the number of Support Workers from 23.2FTE to 6FTE and to create 18.5 new Assistant Support Worker posts within the service which displaced support workers will be encouraged to apply for.*
>
> *Barnet Independent Living Support - Support Staff are currently graded at a different level to their colleagues in other services whilst doing a very similar job. With the merger of BILS and Community Space the proposal is to delete the 5 posts of Independent Living Facilitator and 2 Assistant Independent Living Facilitator and create the equivalent number of new Support Worker and Assistant Support Worker posts in the new combined service, into which staff will be assimilated."*

Cuts to pay terms and conditions

> ***"Review of salaries***
>
> *We have carried out an initial benchmark exercise with some of our competitors and our findings so far suggest that our salary costs are higher both at hourly and monthly rates. To ensure our position in the market in order to win new business we propose that an independent benchmarking exercise is carried out and to implement the findings of the benchmarking exercise to restructure our salaries as part of this review. This will ensure that we are competitive in the market to win new business and that our costs are sustainable."*

CHANGES TO TERMS AND CONDITIONS

> ***"Enhanced payments***
>
> *In 2012-13 we spent over £160,000 on enhanced pay for staff working weekends, public holidays and at night. We are not paid a premium rate for weekend activities and nor is there a possibility to do so within the market, as commissioners are increasingly relying on Framework Agreements to set the rates for particular types of services.*
>
> *At the same time, we have aspirations to develop the flexibility to offer Day Services at weekends. It will be vital to the ability of YCB to compete in the market and that staff salaries are affordable and that we do not lose money by having to pay more than any hourly rate we can attract. It is however also important that the quality of services remains high.*
>
> *It is therefore proposed that all staff are paid a flat rate for working over seven days and that enhancements cease to be paid on top of basic salaries, except for Christmas Day. Staff will continue to be able to claim a day in lieu of work on Bank Holidays."*

The 90-day consultation started on 1 March 2013 and Barnet's UNISON branch has stepped up its campaign for the services to be returned in-house.

Further information:

Analysis of Business Case for Local Authority Trading Company: Future of Adult Social Services In-house Provider Services Project; London Borough of Barnet; May 2011

http://www.european-services-strategy.org.uk/news/2011/analysis-of-business-case-for-local-authority/barnet-latc-business-case.pdf

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