

CIPFA London Division

A commercial risk too far?

8 March 2019



Welcome & introductions

Nick Carroll
Chair
CIPFA London Division



Agenda

- 9.30 Chair's Introduction and Welcome
- 9.35 London Division AGM
- 9.45 **Gareth Davies**, Head of Public Services, Mazars
- 10.10 **Eleanor Kelly**, Chief Executive, London Borough of Southwark
- 10.35 Coffee Break
- 10.50 **Neil Wright**, Deputy Commercial Director, Guy's and St Thomas' NHS Foundation Trust
- 11.15 **Michael Richardson**, Deputy Commercial Director, Ministry of Justice
- 11.40 **Brian Roberts**, Director of Local Government, CIPFA
- 12.00 Panel Debate
- 12.30 Buffet Lunch

London Division AGM

1. President's welcome
2. Apologies for absence
3. Minutes of meeting held on 30 June 2017
4. Matters arising
5. Executive Committee for 2018/19
6. Honorary Secretary's report
7. Honorary Treasurer's report
8. Appointment of auditor
9. Any other business

Gareth Davies Head of Public Services, Mazars

Comptroller and Auditor General Elect





COMMERCIALISM IN PUBLIC SERVICES

An auditor's view

Gareth Davies, Mazars LLP

1. BRIEF HISTORY
2. MOTIVATION
3. CURRENT ISSUES



BRIEF HISTORY OF COMMERCIALISM IN LOCAL GOVERNMENT

- 19th century expansion of local government role in utilities (water, sewage, street lighting etc.)
- 20th century expansion of council housing
- CCT from the 1980s
- PFI from 1990s
- 'Strategic partnerships' largely focused on back-office services
- Localism Act 2011 General Power of Competence
- Local authority-owned companies
- Commercial investments to generate revenue



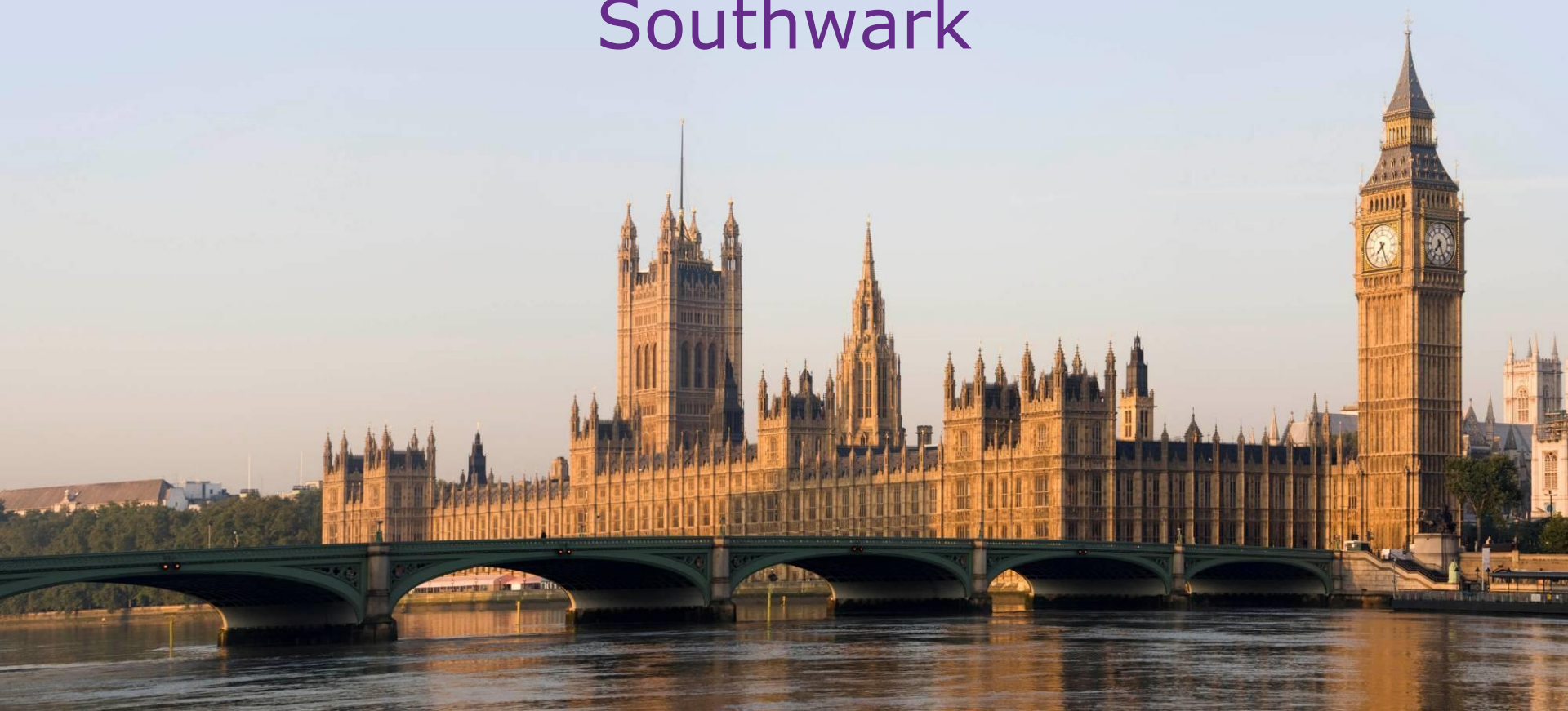
- Reducing costs
- Protecting services
- Protecting jobs
- Responding to market failure
- Promoting local economic development
- Realising the value of intellectual property and expertise
- Replacing lost central funding
- Generating revenue for spending on core services



- Exposure to the collapse of major private sector contractors (Carillion, social care providers etc.)
- Managing the risks associated with ownership of commercial ventures
 - conflicts of interest
 - realism of business plans
 - access to required skills at affordable (and politically acceptable) pay levels
 - impact on local businesses
 - distraction of leadership focus on core business
- Learning the lessons of the past in managing commercial investment
 - Interest rate swaps, Icelandic banks, PFI, LOBOs
 - Short term gain at what risk
 - Moral hazard

Eleanor Kelly

Chief Executive, London Borough of Southwark



Break



Neil Wright

Deputy Commercial Director, Guy's and St Thomas' NHS Foundation Trust



CIPFA London event: Impact on commercialisation within the NHS

Mazars LLP, 8 March 2019

**Neil Wright, Deputy Commercial Director,
Guy's & St. Thomas' NHS Foundation Trust**



Who we are

- **Biggest NHS Foundation Trust in the NHS**
- **900 years old**
- **Home of Florence Nightingale and Mary Seacole**
- **16,000+ staff**
- **2.5 million patient contacts per year**
- **£1.48bn turnover 2017/18**

- **Fully integrated acute and community services as well as education, research and academia, across 3 hospital sites**

Governance Structure

- **Board of Directors**
 - Set strategic direction of the trust
 - Monitor performance against objectives
 - Provide effective financial stewardship
- **The Committees**
 - Support the Board on a variety of issues including:
 - Quality and performance
 - Risk and assurance
 - Information governance
 - Quality Improvement
 - Clinical audit
- **12 Corporate Directorates** (all with clinical lead)
- **19 Clinical Directorates** (all with management team including clinical director, general manager, head of nursing, head of finance)

- **Largest dedicated commercial unit within the NHS**

GSTT: Ambitious Commercial Service Lines

Commercial Directorate operates multiple profit streams

International Development	Education and Events	UK Business Development	Private Patients	Intellectual Property & Commercial Research	Consulting
Commercial Contracting					
Commercial Finance					

Guy's and St Thomas Enterprises Ltd

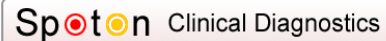
- Holding Company established in 2007; developed into portfolio management Company in 2014
- 7 Directors -Trust Directors and Non Executive Directors from industry and private equity / venture capital background
- Active approach to managing the Trust's shareholder interests in the portfolio Companies



- Wholly owned subsidiary – services spin out from Trust Capital, Estates and Facilities Department
- Provides property consultancy to healthcare and university sector – UK & International
- c£9m turnover p.a. and generating returns to the Trust



- Joint Venture between the Trust, KCH and Serco Ltd established 2008
- C£125m turnover p.a and a profitable business
- Current focus is on centralising pathology provision across the sector



- IP spin out from GST and KCL – novel technique in newborn screening for blood and metabolic disorders
- Method of choice in UK NHS
- Focus is now on product and international expansion
- C£400k turnover and highly profitable



- IP spin out – innovative imaging application for endovascular procedures
- Successfully raised funds from external investors to fund operations and R&D to date
- Current focus is bringing the product to market

Examples of existing commercial arrangements

British Forces Germany

- Longstanding contract with the Ministry of Defence to provide a comprehensive range of hospital, primary and community health services to British Forces and their families in northern Europe, in partnership with SSAFA, the Armed Forces charity

Diaverum

- Managed Service Agreements with Diaverum for facilities management and nursing at satellite dialysis units

Lloyds's Outpatient pharmacy partnership

- Partnership with, pioneering agreement of its kind, allowing higher quality of service delivery and improving patient access to choice of pharmaceuticals

Johnson & Johnson

- Enabling significant investment in expanded facilities and improving supply chain and patients' experience through increased theatre and R&D capacity

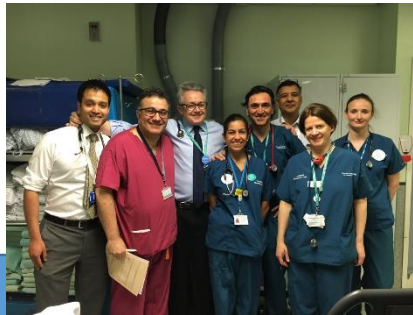
Lane Fox's

- Partnership with REMEO Ltd based in East Surrey Hospital creating a 20 bedded weaning unit allowing clinical care to more patients with chronic respiratory failure

The profits made by commercial services directly deliver value to the Trust



925 nurses



278 consultants



5 Theatres

Developing experience & lessons learned

- **How to engage with 3rd parties and industry**
 - Options
- **Identifying win/win scenarios**
- **Identifying commercial opportunities**
- **Correct and appropriate structures**

A few numbers that may surprise you

Our profits per employee are equivalent to those achieved by National Grid or Standard Life Aberdeen

nationalgrid

Standard Life
Aberdeen

In terms of number of employees we are approaching half of the headcount in 3i

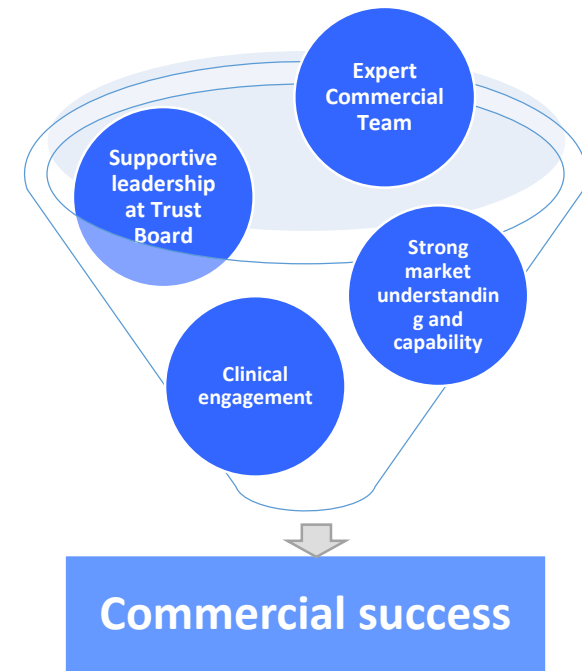
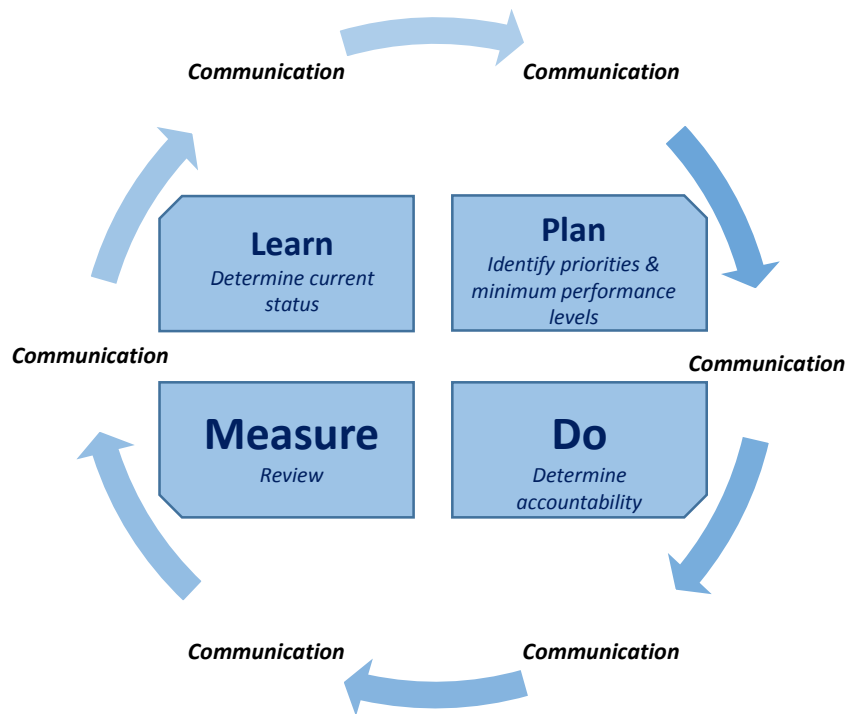


In terms of revenue we manage a similar revenue per person as Centrica or British Land

centrica
Business Solutions



Ingredients of Commercial success



Regulatory engagement

- Partnership & checks & balances -

- Multiple regulators: CMA competition law, NHSI subsidiary companies requirements, Treasury
- Consider all impacts of regulations
- Proactive engagement: GSTT proactively engages with all regulators
- Close relationship benefits all parties: regulators with good understanding can make more informed choices
- Timeliness of decisions

Discussion

Encourage & Facilitate Excellence

Michael Richardson

Deputy Commercial Director, Ministry of
Justice



Managing commercial risk in large scale government contracts

**Michael Richardson, Deputy
Commercial Director, Ministry of
Justice**



Overall Risk Strategy


- Placing risk with the party best able to manage it will lead to:
 - optimal pricing from the suppliers
 - fewer performance and commercial issues during the contract term
 - a reduced likelihood that the contract fails completely, and the supplier prematurely exits the agreement or becomes insolvent
 - a climate of open and honest business dealings for mutual benefit





Risk Factors (1)


Key factors that help determine the level of risk to be transferred to a supplier are:

- the level of control required in **how** the services are delivered
 - the ability and readiness of the supply market to bear any risks associated with the delivery of the service and (if applicable) any transformation programme
- 



Risk Factors (2)

These factors are influenced by:

- whether the service is being outsourced for the first time;
 - the maturity of the supply market in delivering similar types of services;
 - the complexity of the services required;
 - the scale of transformation the Contracting Authority is seeking;
 - the extent and quality of supporting data;
 - past experience of delivering similar types of services
- 



Risk Challenges (FM)




- Volume Changes
- Poor asset information - quantity and quality
- Changes in Law
- Poor infrastructure
- Unlimited liabilities






Lessons Learnt from Carillion

- Improved risk analysis and allocation
 - Due diligence and market intelligence
 - Greater emphasis on financial analysis
 - What if scenario development
 - Improved use of contract tiering
 - Pro-active reviews of 'gold contracts'
 - Improved contract management
 - Pre and post 'go-live'
 - Improve Contingency Planning
 - Resolution Planning
- 



How have the MOJ addressed such risks?

- Deployed different solutions across different markets
 - Brought some back in-house
 - Extended some contracts
 - Transferred some contracts
 - Varied some contracts
 - Competed some direct awards
 - Developed contingency plans with key suppliers
 - Reviewed risks for all 'gold contracts'
 - Guidance - **The Outsourcing Playbook**
<https://www.gov.uk/government/publications/the-outsourcing-playbook>
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Brian Roberts

Director of Local Government, CIPFA



Commercialisation

CIPFA's response to the changing landscape

Brian Roberts CIPFA Director of Local Government
March 2019

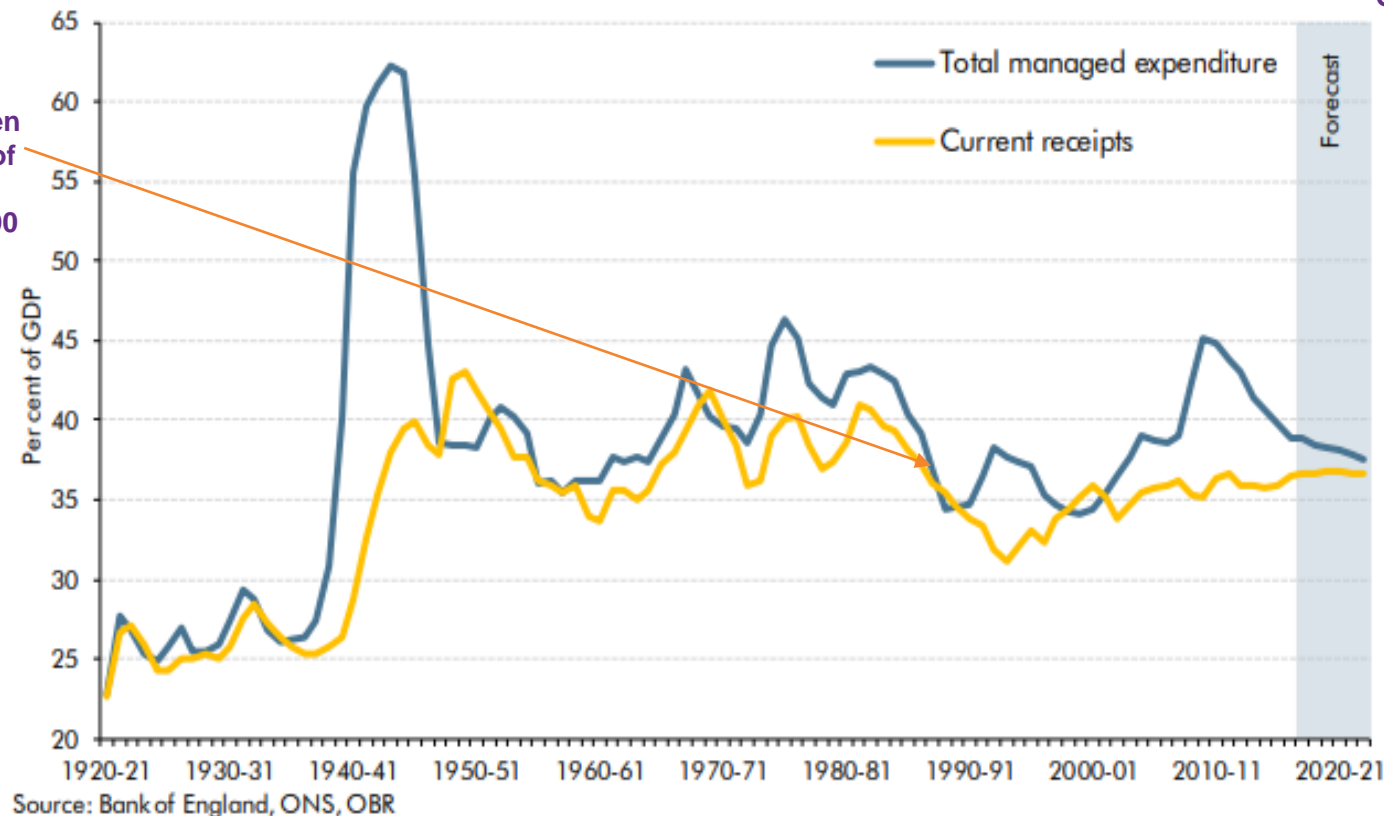
The State of Public Finance

- No government can maintain public services of the current scope and nature without tax rises.
- Receipts have not been above 37% of GDP since 1989/90
- Tax receipts will equal health, long term care, pensions and pensioner benefits.
- Sustained real-term falls in government funding – 56.3% reduction by 2019/20.
- Local Authorities facing increasing demand and reduced funding -February 2019 Clive Betts announced wide ranging enquiry into Local Authority Finances



Successive governments have not been able to raise the taxation necessary to balance the budget

Chart 4.12: Total public sector spending and receipts



Source: C

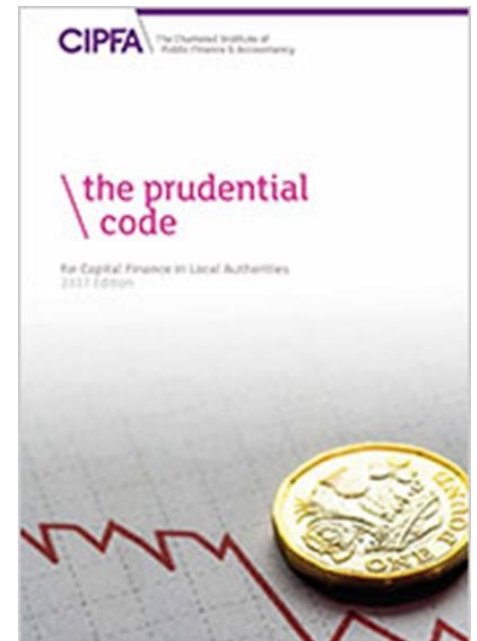
Growing Trends

- Increasing trend for authorities to purchase property solely to make an investment return
- New approaches to risk management
- New management of risk exposure
- Commercialism
 - Wide range of activities
 - Press debate focus



Response

- CIPFA
 - Revision in the CIPFA Prudential Code
 - Revision in the Treasury Management Code
 - Statement from the Treasury Management Panel
- Government
 - Update to Statutory guidance
 - Minimum revenue provision



Statutory Guidance on Local Government Investments - Extracts

Proportionality [paragraphs 44-45]

30. Local authorities need to consider the long term sustainability risk implicit in becoming too dependent on commercial income or in taking out too much debt relative to net service expenditure.

on service delivery. It is unclear whether local authorities who have adopted a debt financed commercial investment strategy have realistic plans to manage failure. Whilst the Government recognises the importance of local authorities taking on debt to enhance service provision, irrespective of the source of finance, it does not believe that it should do the same for commercial investments.

32. For this reason, the Guidance introduces a new requirement that in every local authority, full council or its nearest equivalent, sets limits that cannot be exceeded for gross debt compared to net service expenditure, and for commercial income as a percentage of net service expenditure.

Borrowing for Commercial Investments

THE STATUTORY FRAMEWORK FOR INVESTMENTS 11

193 → For authorities in England and Wales, the 2003 Act removed the doubts that persist in the 1989 Act regime and gives a local authority power to invest for 'any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs'. The reference to 'the prudent management of its financial affairs' is included in the reference to 'the prudent management of its financial affairs' but without the reference to 'the prudent management of its financial affairs'. This would also allow the temporary borrowing of funds for the purpose of expenditure in the reasonably near future; authorities should not borrow in advance of need. The Statutory Guidance on Local Government Investments, MHCLG 2018, in England makes it clear that borrowing in advance of need is not consistent with the principles in the statutory framework and refers also to the Code. Local authorities should not choose to disregard this principle in order to invest in property or other financial investments, paragraph 47 of the guidance requires that local authorities should disclose about their reasons for doing so. 11

Statement from Rob Whiteman (CIPFA Chief Executive) and Richard Paver (Chair of the CIPFA Treasury and Capital Management Panel) on Borrowing in Advance of Need and Investments in Commercial Properties

CIPFA's Prudential and Treasury Management Codes, together with the statutory framework have been reviewed recently. The outcome of the reviews included modification to the controls and guidance related to increased commercialisation in the investment practices of local authorities.

Local authorities have continued to invest in commercial properties. In some cases these investments have been financed by borrowing.

Our statement reminds users of the Prudential Code that the Code sets out clearly that the prime policy objective of a local authority's treasury management investment activities is the security of funds, and that a local authority should avoid exposing public funds to unnecessary or unquantified risk.

Both the Prudential Code and the [Statutory Guidance on Local Government Investments \(3rd Edition\)](#) (Statutory Investment Guidance) issued by the Ministry for Housing, Communities and Local Government are very clear that local authorities *must not* borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Relevant statutory provisions also apply in the devolved administrations.

Local authority investment powers are for any purpose relevant to its functions and for the purposes of the prudent management of its financial affairs. As with all local authority powers they must be used reasonably and in accordance with an authority's primary function as a service provider.

CIPFA considers that where the scale of commercial investments including property are not proportionate to the resources of the authority, that this is unlikely to be consistent with the requirements of the Prudential Code and the Treasury Management Code.

CIPFA shares the concerns raised in relation to the recent continuation and (in a small number of cases) acceleration of the practice of borrowing to invest in commercial property. CIPFA will therefore issue more guidance and will make it clear that these investment approaches are not consistent with the requirements of fiscal sustainability, prudence and affordability.

CIPFA's guidance will also set out the substantial risks which are being incurred by such practices. In the meantime, local authorities are advised to have specific regard to the requirements to compile a capital strategy. Local authorities in England are also directed to have regard to the Statutory Investment Guidance the informal commentary to which cautions local authorities against:

- becoming dependent on commercial income;
- taking out too much debt relative to net service expenditure; and
- taking on debt to finance commercial investments.

Rob Whiteman
CEO CIPFA

Richard Paver
Chair CIPFA Treasury & Capital Management
Panel

... Linking to The Capital Strategy

The capital strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

Para 21 Prudential Code

Extract from The Prudential Code:

‘high level overview’

‘how ..risk managed’

‘Implications for future sustainability’

Steps in decision making

Reflection on the decisions that an authority should take before acquisition :

- Can the LA acquire
 - Powers
 - Borrowing
- Should the LA acquire
 - Reasonableness
 - Regard for statutory guidance
 - Prudent and proportionate
- Will the LA acquire
 - Consistent with strategic direction
 - Competence

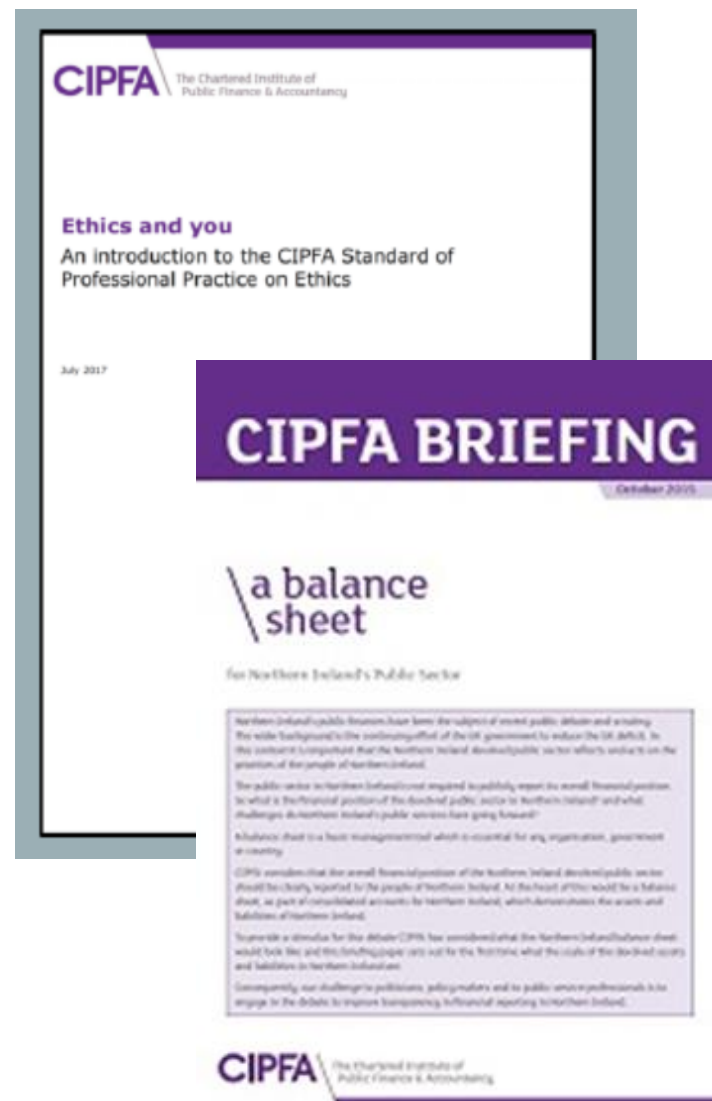
CIPFA responses to direction of travel

- For Councils as organisations, regulation is that they must have regard to the Code.
- MHCLG can provide further advice if needed.
- For professional accountants and auditors holding a CPFA designation, as a professional standard franked by CIPFA Council, it is requirement to follow the Code.
- Policy, technical or professional regulation teams are available for advice and support.



CIPFA's Support

- Available
 - Updated Codes
 - Code of Ethics
 - Capital Strategy
 - Funding Advisory Service (FAS).
 - Resilience reviews
- Coming out in 2019
 - Guidance on Borrowing
 - Financial Management Code
 - Resilience Index



Panel Debate



Closing Comments

