

From: Stephen Parker
Sent: 11 October 2011 17:41
To: Councillors
Cc: Pam Donnellan; Mike Forrester
Subject: Transformation of Finance
Importance: High
Sensitivity: Confidential

Dear Councillor

It is with a degree of disappointment that I feel obliged to write to you over the Transformation of Finance Cabinet report. This report is being considered by Cabinet on the 12 October 2011.

As I was not provided with a copy of the report and accompanying papers until Wednesday afternoon I have been placed in a very difficult position. Clearly any comments or concerns I might have over the report cannot now be incorporated in the report but as the deputy S151 Officer for the Council I believe I have a professional duty to ensure my concerns are considered prior to a formal Council decision. I have therefore produced the following paper that I have circulated to all Councillors.

Corporate questions

The report does not evidence the consideration given to the financial stability of the commercial partner. It would be expected that the proposal to outsource the financial services of the Council for a nine year period through a private company would require an appropriate level of due diligence and strategic risk assessment to be undertaken by the S151 Officer. This information should be available to Members to allow an informed decision to be made. The commercial partner's press release is not adequate for this purpose.

There should be a clear risk assessment on the financial position of the contractor and the implications of their current financial and market position prior to any new contract extension.

The report should clearly set out a statement by the Council Monitoring Officer on what the contract position would be in the event of a commercial takeover or company liquidation.

It would appear that the phase 2 extension to the contract has been considered without any review of the effectiveness of the phase 1 contract. It is best practice to ensure that the current contract is delivering on its stated savings and service improvements before it is extended to further services.

As the Chief Accountant I have expressed serious doubts about the value for money and deliverability of the contract. The financial accounts of the Council show no sign of disproving these concerns.

- The transformation programme savings have been reduced in the proposed Medium Term Financial Plan (MFTP) by £42m over the period 2012/13 to 2016/17.

- The total cash spend by the Council on the outsourced services is now £3m greater than the pre contract Council budget.
- The costs of asset management have increased from £0.7m (pre contract) to £2.2m (31 March 2011), an increase of £1.5m. The contract payment for asset management is now substantially greater than spending on actual building work.

The report should include a review setting out the progress of delivering service improvements and budget savings from the current contract against the approved business case.

Appraisal of Financial Proposals

The Cabinet report does not provide any evidence that a professional appraisal has been undertaken between the in-house proposal and the commercial partner proposal. At most the report represents a high level cash comparison based on a set of adjusted figures. There would appear to be a lack of detailed financial understanding and a lack of financial knowledge and appraisal skills.

Financial Options – In House proposals

The In-house proposal has been altered from that presented to the Business Improvement Team without any consultation or evidence to support them. These changes include:

Press
reference
to 5
"errors"
or
changes

- Removal of system implementation costs of £736k. The balance of £112k has been erroneously added to the residual internal borrowing and is an overstatement. The internal borrowing costs should be reduced accordingly.
- Inclusion of additional costs of £164k for 'BH Live GL adj' that have been added in after submission by Financial Services. There is no explanation of this cost or if an equivalent item has been added to the commercial bid.
- Removal of staff saving before the introduction of a new GL system of £151k. There is no justification given for the removal of these savings.
- Inclusion of system procurement costs of £100k. The in-house proposal anticipated that any procurement process would need to be completed in 2011/12 and met from existing resources.
- Reduced savings of £133k for 'error in staff savings'. Again there is no justification given for the reinstatement of these savings.

The in-house proposal should be restated to remove these errors and changes.

Financial Options – Commercial Proposals

It is clear from the report (paragraph 3.2) that substantial negotiations have been undertaken by the Council team with the commercial partner in preparing this report. It is unfortunate that Council Officers should so clearly identify with one proposal without making any effort [failure to] to consult with its own staff over the potential

benefits of a retained service. This indicates a clear bias towards a preferred external solution and must raise serious doubts about the objectivity over the preparation of this report.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The report should include a clear appraisal on the capacity and resilience of the contract proposals for the delivery of an effective and sound financial service to the Council. This appraisal should be informed by a detailed Council prepared service specification.

[REDACTED]

Other Comments on the Cabinet Report

Para 7.2 A review of the CIPFA benchmarking statistics do not show that those Councils that have been subject to the contractors 'tried and tested approach to Financial service delivery' are more efficient than other comparable Councils. In fact for one Unitary Council subject to Mouchel management the financial service costs are substantially higher than those delivered by Bournemouth whilst a County Council reference site does not even achieve an average score when compared to comparable authorities.

This paragraph also implies that the Council has not produced a detailed contract scoping document or set of Key Performance Indicators and is entering into a contract on the basis that these details will be agreed later.

The report should include a clear explanation on what constitutes top quartile financial services and evidence how the contract performance will be assessed and measured against a Council defined service quality threshold.

Para 8.2 the new post of Head of Financial Reporting and Projects will be responsible for 'managing and commissioning additional work resulting from new initiatives and projects'. There is no evidence that this new financial liability to the Council has been allowed for as a contract risk within the option appraisal or in the cost assessment.

Para 8.7 This paragraph appears to be delivering an answer to the question of 'conflict of interest' where the control of strategic data and the delivery of advice could lead to the contractor receiving future financial advantages. Unfortunately the paragraph completely fails to appreciate that the problem lies with the contractor control of the Council's systems and not the 'cost of delivering the contract' contained in the contractors accounts. This issue is a real one and the response in the report shows that the author does not understand the risk.

Para 9.8 Does this refers to the Mouchel CEO who has just resigned.

Para 11.2 the FBC was prepared by the contractor for the contractor. The preferred option for system and transformation change provides substantial consultancy benefit to the contractor and valid alternatives that could have potentially delivered better value for money at a lower investment cost have been ignored.

Para 11.2.3 If the Council should decide on retaining ownership of any new system then a contract for implementation would need to be agreed. A separate implementation contract would place the risk for implementation on time, on specification and on price with the contractor. This 'risk' will be priced into the implementation cost if it is undertaken as a stand alone contract (potentially supporting the in house service) or as part of a wider outsourced contract.

What is not clear from the report is the legal position over the ownership and funding of the IT investment. The report states that this cost has been excluded from both options and that the Council will fund this investment. Procurement and ownership of

the system will be retained by the contractor as this removes the need for a public procurement process. This raises a number of issues:

- Is this investment deemed to be a non tangible capital asset with funding through prudential borrowing?
- Can the Council use prudential borrowing to 'buy' an asset it will not hold on its balance sheet. How will this be shown on the capital accounts?
- As the Council will be raising the cash and meeting the revenue costs of repayment will this payment need to be shown as a 'soft loan' to Mouchel in the council accounts
- If it constitutes a soft loan is the Council legally permitted to subsidise the contractor.
- If the contractor 'owns' the asset what safeguards does the Council have in the event of company liquidation over the continued use of the asset?

Put bluntly if the contractor buys the IT system then they should pay for it. The Council could give them a market based loan if it considers them credit worthy. If the Council pays for the asset it should appear on the Council's balance sheet. Under this situation the Council would need to follow normal procurement rules.

The report should include clear guidance on the legal and financial implications of the proposed IT investment.

Para 11.2.3 It is not clear if the offer to meet the ongoing software licence costs are net of the Oracle costs currently paid to the contractor as part of the existing contract.

Para 11.3.10 the report identifies that the Mouchel proposal includes provision of £300k for staff exit costs. It does not appear that the Council has given any thought to the risk of including this provisional sum in the regular contract payment. The original contract contained £1.2m of staff exit provision and it is not clear how or when any unspent provision will be recovered by the Council.

The report should include clear guidance on the process within the contract for the recovery of unapplied staff exit costs and the consideration of alternative arrangements under which the Council holds the funding until exit costs are agreed.

Para 11.3.11 the summary table should be reduced by £175k to reflect the risk of transferring BH Live support costs to the Trust and £62k for the FBC investment.

Option Appraisal Appendix 1 – Due to the lack of any evidence that the two options have been subject to effective scrutiny it is difficult to place reliance on the option appraisal section. The majority of appendix 1 reads like a sales document prepared by the Council on behalf of the commercial partner, a feeling reinforced when it is read alongside Appendix 2.

The risk assessment has been based on the various 'guarantees' offered by the contractor but without any assessment of the inherent risks usually identified with outsourced contracts. These include loss of control and flexibility, increased costs

through contract omissions and changes, conflict of interest and reduced service capability. The report appears to be based on a cultural belief that only an external consultant can deliver change or is capable of implementing projects.



The report should include clear guidance on the appropriateness of the financial risk ‘guarantee’ against the potential costs of service failure. This should include the consideration of penalty payments for specific high risk failures or omissions.

Conclusion

The Cabinet report does not provide an adequate assessment of risks or deliver an independent and robust evaluation of the two options considered.

The option decision process has confused the delivery of service improvement through investment with the delivery of the service. In practice only one option has been considered but subject to two choices over who delivers it.

The inclusion of a robust Public Sector Comparison (PSC) has clearly ‘sharpened’ the pencil of the contractor compared to the costs set out in the Full Business Case. It is unfortunate that PSCs were not prepared as part of the original contract report.

That the Council ensures that any future proposal for outsourced services contains a robust and objective PSC as a way of showing the delivery of value for money.

At no point has the Council considered the scope of outsourced service or looked at the options for outsourcing specific and defined areas of Financial Services that would have provided a more balanced financial and risk assessed contract. This route is the normal one taken by Council’s in preparing any outsourcing.

I hope that Members will find this note stimulating and useful when considering the various Cabinet papers tomorrow.

Stephen Parker
Chief Accountant
11 October 2011

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