

# HPST PROPOSAL

## Appendix 4

### THE EMERGING FINANCIAL CASE

#### **Introduction**

One of the three key purposes of the proposed Herefordshire Public Service Trust (HPST) is that it will *provide better value for money services for taxpayers, achieving savings on management costs as the Public Service Trust moves to a single management structure.*

The purpose of this paper is to make a start in fleshing out the financial case for the proposal by estimating the Value for Money gains that could be achieved. The figures outlined in this preliminary assessment are provisional. This is to be expected given the proposal is still at concept stage. The estimates are a guide to the potential costs and savings, and work will continue to further review and refine the figures. However, the indicative scale of the costs and savings demonstrate the affordability of the proposals.

#### **The Financial context**

At national level, the government has set the financial context for public spending within which the Comprehensive Spending Review 2007 (CSR07) will be conducted. The CSR07 is the first comprehensive review of public spending for ten years and will establish national priority outcomes and funding levels for the three-year period covering 2008/09 – 2010/11. The CSR07 is due to be published in autumn 2007.

The March 2007 budget confirmed the expected slow-down in growth in public spending which will be limited to just 1.9% in real terms. Within this overall target for growth, health and education services will be awarded real terms growth of 4% and 2.5% respectively. It's not as much as either service area believes is needed but is considerably more generous than the rest of the public sector can expect.

With education and health services getting a higher level of growth than the overall figure the government is planning on, the situation actually looks quite stark for all other public services. The government is likely to avoid headline cash reductions in spending in these areas by factoring assumed efficiency gains – of up to 3% - into their calculations and by including specific funding streams in general grant support. Whatever the headlines say when the local government finance settlement for 2008/09 – 2010/11 is announced in December 2007, a cash standstill is the best that can be hoped for in local government when all funding streams are taken into account.

Herefordshire Council has been preparing for the tougher times ahead through its corporate and financial planning processes. The Council's Medium-Term Financial Management Strategy (MTFMS) takes into account the national and local context in assessing the likely level of resources available, and ensures those resources are allocated in line with key corporate priorities. One of those key corporate priorities is a major business

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transformation programme called Herefordshire Connects that is already underway. Herefordshire Connects will ensure financial stability over the long term by releasing resources for investment in service priorities such as social care.

Whilst the financial outlook for health might appear less difficult than that for local government, the challenges ahead are still considerable. The health service has to contend with much less certainty on resource limits from year to year and indeed within year. This makes longer-term corporate and financial planning more challenging. Like local government, public expectations and demand for services continues to increase and the government has set tough targets for improving waiting times that could lead to significant pressure on financial resources given the Payment by Results regime.

The financial challenges that lie ahead for public service organisations in Herefordshire are exacerbated by the fact that their per capita funding is often well short of even the average for similar organisations. This happens because the resource allocation methods the government uses are generally good at reflecting cost drivers (such as demographics and deprivation) but not cost factors (such as additional staffing and transport costs in rural areas).

This is a particular issue for Herefordshire because the population is much more evenly dispersed throughout the entire county area than it is in most other rural areas. Herefordshire is almost at the bottom of the league table for funding per pupil (147<sup>th</sup> out of 149) and receives 21% less funding per head of population for other local government services than the average for a unitary authority.

Herefordshire has a relatively poor funding position with no sign of relief in the future given the national financial context outlined above. Making every public £ available for public services for Herefordshire citizens go as far as possible has to be a high priority for all the organisations within the Herefordshire Partnership umbrella. The Herefordshire Public Service Trust (HPST) proposal has the potential to achieve more in terms of improving Value for Money than the two organisations could achieve separately.

## **Policy context**

There are a number of government initiatives aimed at improving health and local government services that the Council and the PCT are responding to both separately and jointly. Examples include:

- Further Education & Training Bill;
- Offender Management Bill;
- Criminal Justice Bill;
- Climate Change Bill;
- Road Transport Bill (draft);
- Concessionary Bust Travel Bill;
- Border and Immigration Bill;
- Energy White Paper;
- Planning Reform;

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- Local Better Regulation Office Bill;
- Mental Health Bill;
- Statistical Reform bill;
- Our Health, Our Care, Our Say White Paper;
- The Choosing Health agenda;
- A New Ambition for Old Age: Next Steps for Implementing the Older People’s National Service Framework; and
- Welfare Reform Bill.

Sources: Herefordshire Council’s Medium-Term Financial Management Strategy 2007 - 2010 and Herefordshire PCT’s Local Delivery Plan 2007/08 – 2008/09.

One significant government initiative that affects both partners – and the wider Herefordshire Partnership – is the Local Government White Paper (LGWP). The key features of the LGWP are as follows:

- A new area based performance framework;
- An enhanced role for councils as strategic leaders and place-shapers;
- Further development of Local Area Agreements (LAAs);
- Stronger political leadership;
- An invitation to consider alternatives structures in two-tier areas;
- A strengthened role for frontline councillors;
- A wider and stronger role for scrutiny;
- Devolution of some powers; and
- Using community strategies to enhance community cohesion.

Whilst some commentators have noted that the LGWP is just one step short of a public services white paper, it clearly paves the way for innovative proposals such as the HPST, especially as cross-government funding streams are brought together in the next generation of Local Area Agreements (LAAs).

## Meeting the challenges for public services in Herefordshire

Given the financial and policy context set out above, the key challenges for public services in Herefordshire and how the HPST proposal will help address them are summarised in the following table:

<b>The challenges for public services in Herefordshire</b>	<b>Moving to one public service organisation for Herefordshire will:</b>
<b>Improving efficiency</b> – government has set cash targets as high as 3% a year for some public services at a time when planned growth in public spending is slowing down	Release further savings building up to £3.5 million a year for re-investment in priority public services
<b>Improving the quality of services</b> – meeting the specific needs and preferences of individuals in how they access and receive services	Allow further integration of service provision so services can be tailored to meet individual requirements

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<p><b>Improving customer satisfaction</b> – the public often think public service organisations are remote</p>	<p>Reduce the number of bodies commissioning public services in Herefordshire, improving access to services for individual members of the public and for GP services and public accountability</p>
<p><b>Improving Value for Money</b> – maximising the use of resources including assets, finances and ICT</p>	<p>Bring corporate, service and resource planning processes together to ensure resources are effectively allocated to priorities for the community</p>
<p><b>Responding to national and local trends in demography</b> – such as the increasing numbers of older and vulnerable people</p>	<p>Enhance the capacity each organisation has separately to deal with these challenges</p>

### **Main financial benefit – improving Value for Money**

Herefordshire Council scored three out of four in its Use of Resources CPA assessment for 2006. Herefordshire PCT scored two out of four in its Auditor's Local Evaluation for 2006. These assessments are essentially identical. The judgements are made by the external auditor against a set of detailed criteria covering financial reporting, financial management, financial standing, internal control and Value for Money.

On the Value for Money theme, the Council's external auditor commented that the Council still achieves a lot for its level of resourcing, noting in particular that:

- Spending on services is below average when compared with similar councils;
- Service outcomes in some areas are good and some improvements have been achieved; and
- The capital programme is linked to priorities and is reasonably well managed.

The PCT's external auditor commented that the PCT routinely delivers efficiency targets by top-slicing further budget allocations, noting in particular that:

- Budget constraints have led to new ways of delivering services in order to make efficiencies; and
- The PCT has considered opportunities for improvement in procurement and use of shared services.

Both organisations have an established and improving track record for achieving Value for Money by reducing costs and making improvements in efficiency and effectiveness. Moving from two organisations into one could enhance the quantum of savings and efficiency gains that could be delivered separately, and increase pace and capacity for further improvement in the longer term.

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The most obvious example of improved Value for Money offered by the HPST is the elimination of duplicated corporate management costs. Creating one senior officer management team to replace the two that currently exist would save money.

The PST Steering Group has agreed a set of principles for organising corporate resource management and other support services if the HPST proposal goes ahead. The aim at the moment is to aggregate such services where it makes sense to do so. This suggested arrangement could offer improved Value for Money by achieving economies of scale in services such as:

- Asset Management & Property Services;
- Finance;
- Human Resources;
- Information & Communications Technology (ICT);
- Legal; and
- Procurement.

Although there are significant complexities associated with the integration of ICT, the benefits could be considerable, especially when complemented with management savings.

Rationalisation will also lead to cash savings and efficiency gains. The Corporate Resource, Finance & ICT Working Group has already identified a quick wins in using existing office and training accommodation more effectively.

Exploiting service synergies – for example integrating health and social care support services for improving performance on hospital discharges - could lead to greater efficiency. The Council and PCT are already working together to develop the Integrated Community Equipment Store service. By working together as one organisation, the transition from health to social care services could be managed even more effectively and care packages agreed with the customer / service user that do more to meet their specific needs.

Increased effectiveness in procurement will also deliver cashable savings that can be re-directed to more and better frontline service delivery. The new organisation's combined purchasing power should lead to reductions in the cost to buy goods and services. A common purchase to pay system will reduce the transaction cost involved in buying goods and services from the ordering stage through to final payment. And, working together as one, the HPST could begin to intervene in key markets to get a better deal for our community and the public purse.

The Council has already embarked on a major business transformation programme called Herefordshire Connects. This programme involves a fundamental re-think of the way in which the Council supports its business functions and delivers services. The programme will unlock resources as it:

- Removes duplication of activity;
- Facilitates asset rationalisation;

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- Enables integration of customer facing and business support processes;
- Exploits service synergies;
- Improves efficiency and effectiveness.

Herefordshire Connects will release cash and generate efficiency gains that can be re-invested in the Council's frontline services. The return to investment ratio is estimated at 2:1 with annual savings building up to £11.75 million. Extending this programme to the new public service trust to could yield further cost savings and improvements in service provision and enhance the overall return to investment ratio.

## Setting the financial scene

### Revenue spending

The PCT's net revenue budget amounts to £233 million in the current financial year. A broad analysis of this figure is as follows:

Service area	PCT Net Revenue Budget (£ million)		
	HPST Services *	Other Services *	Total
NHS Service Level Agreements	105	-	105
Other Service Level Agreements	11	-	11
Primary Care Prescribing	28	-	28
Primary Care Infrastructure	4	-	4
General Practitioner Services	21	-	21
Dental Services	8	-	8
Mental Health Provision of Services	-	11	11
Community & Specialist Services	-	27	27
Corporate & Financing costs	6	6	12
Reserves & Developments	4	2	6
<b>Total budget (£ million)</b>	<b>187</b>	<b>46</b>	<b>233</b>
Percentage	80%	20%	100%

\* The analysis of budgets between HPST and other services is indicative only. HPST Services includes all commissioning activities.

The PCT's net revenue budget is supported by a resource limit provided by the Department of Health.

The Council's net revenue budget including schools amounts to £204 million in the current financial year. A broad analysis of this figure is as follows:

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Service area	Council Net Revenue Budget (£ million)		
	HPST Services *	Other Services *	Total
Children & Young People	91	16	107
Adult & Community Services	22	25	47
Corporate & Customer Services	2	5	7
Environment	22	5	27
Central Services & Financing Costs	1	15	16
<b>Total budget (£ million)</b>	<b>138</b>	<b>66</b>	<b>204</b>
Percentage	68%	32%	100%

\* The analysis of budgets between HPST and other services is indicative only. HPST Services includes all commissioning, customer service and regulatory activities.

The Council's net revenue budget is funded as follows:

Source of funding	(£ Million)
Dedicated Schools Grant	82
Council Tax	74
Formula Grant	48
<b>Total</b>	<b>204</b>

## Capital spending

The PCT receives an annual block allocation for capital from the Department of Health of approximately £900,000 a year.

The Council plans to spend £63.7 million on capital projects in 2007/08. Borrowing will finance approximately 57% of this spending with capital receipts and government grant being used to pay for the remainder. The main schemes are as follows:

- Riverside junior and infant school amalgamation (Hereford);
- The Minster High School replacement (Leominster);
- Sutton St Nicholas primary school replacement;
- Cattle Market relocation;
- Herefordshire Connects;
- Highways & bridge maintenance including Rotherwas access;
- Ross-on-Wye flood alleviation scheme;
- New crematorium (Hereford);
- Private sector & affordable housing grant;
- Friar Street museum resource & learning centre;
- Extra care housing development; and
- Disabled facilities grants.

The Council is also reviewing its accommodation strategy for the future as part of an asset rationalisation programme. This review will encompass discussion with all of the Council's strategic partners, including the PCT, to establish if there are opportunities for co-location. There is further potential to

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maximise Value for Money and improve service efficiency and effectiveness by considering HPST needs as part of the options appraisal process that is currently underway.

## Reserves

The PCT's net revenue budget for 2007/08 includes £6 million earmarked for Reserves & Developments, rising to £12 million in 2008/09 and £18 million in 2009/10. This represents 2.6% to 7% of the net revenue budget. The £6 million available in the current financial year has all been allocated to developments leaving nothing in reserve. The Reserves & Development funding for 2008/09 and 2009/10 has not yet been allocated to developments but the expectation is that they will be in due course through the Local Delivery Plan process.

The external auditor has scored the financial standing element of the Auditor's Local Evaluation for the PCT for 2006 as 3 out of 4. This reflects the fact that the PCT achieved the financial targets set by the Department of Health in 2005/06 without any support. Financial targets were also achieved in 2006/07 including a significant cost improvement programme.

The Council currently has approximately £10 million in its General Fund Reserve. This represents 8.2% of the net revenue budget excluding schools. The schools hold balances of approximately £8m and there are further specific reserves of approximately £10m being held for waste, Herefordshire Connects, social care and invest to save initiatives.

The external auditor has scored the Council's financial standing element of the Use of Resources assessment for 2006 as 2 out of 4. The external auditor noted that there was significant improvement in the approach to managing budgets and reserves in 2005/06 but felt there was scope for further improvement in reporting on the level of reserves needed and management of income streams.

The Council's unallocated reserve funding position is healthier than many local authorities. The PCT is currently operating without unallocated reserve funding, as is often the case in the health sector. Achieving financial stability for public services into the future is important to both partner organisations. As the external funding situation tightens, the temptation is to use available reserves to balance the budget rather than bring about changes in service delivery that will release cash and efficiencies for the future. More can be achieved by acting in concert through the HPST than could be separately. The reserve funding position should provide sufficient temporary funding to pay for any transitional costs.

## **The Emerging Financial Case**

The emerging financial case shows that savings building to over £3 million a year could be achieved by the end of year three by taking advantage of the various opportunities described above. It is important to note that the



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emerging financial case outlined below is a working hypothesis at this stage. It makes no allowance for the options included in the consultation paper on the future of health care provider services.

The Corporate Resource, Finance & ICT Working Group has looked at the potential financial gains from creating a single public service trust for Herefordshire. The figures are indicative only at this stage but appear to be realistic and prudent when compared to the outline benefit plans for the Herefordshire Connects programme and the current round of unitary authority bids in local government. The Working Group has also considered the 'quick wins' identified by each of the eight PST Working Groups to date.

It is estimated that the rationalisation of senior management structures would produce savings building to £450,000 a year as the HPST is established. This figure does of course depend on actual salaries and assumes that any reduction in the number of posts at the most senior level is not offset by an increase in posts at lower levels.

The outline financial case for the Herefordshire Connects programme has been used as a model for estimating the potential costs and benefits of establishing the HPST.

In calculating the potential benefits, a key assumption is that the PCT's cost structure resembles that of the Council. The likely level of savings on staffing, supplies & services, property and ICT budgets has however been scaled back from the level expected from the Herefordshire Connects programme. The resulting model produces eventual savings on the PCT's gross budget of 0.8% or £1.9 million a year.

The benefits of the Herefordshire Connects programme for the Council are expected to build to £11.75 million after three years or 4% of gross budgeted spending. Extension of the Herefordshire Connects programme to include the HPST should provide the capacity for further improvements in efficiency and effectiveness. This has been included in the outline benefits model as building to £1 million a year.

The following table gives a guide to the potential benefits of the HPST proposal:

Benefit stream	Saving (£000)			
	Year 1	Year 2	Year 3	Total
<b>Shared budgets</b>				
Elimination of duplicated management costs	150	300	450	<b>900</b>
<b>PCT budgets</b>				
Cash released from PCT budgets	500	1,200	1,900	<b>3,600</b>
<b>Council budgets</b>				
Further cash released from Council budgets	500	750	1,000	<b>2,250</b>
<b>Total</b>	<b>1,150</b>	<b>2,250</b>	<b>3,350</b>	<b>6,750</b>

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The Council has a cost model for Herefordshire Connects that covers the resources needed to deliver the programme (such as project management costs, organisational development, etc.) as well as the investment requirement in change management and technology. It has been assumed that the additional resourcing costs would be half that currently anticipated by the Council. As a guide, the additional investment needed to deliver the benefits has been included on a marginal cost basis and allowed for at 15% of the investment requirement currently anticipated by the Council for the Herefordshire Connects programme. The assumption is that the main focus of additional cost would be in change management support as opposed to the technology solution.

The following table gives a guide to the potential costs associated with the HPST proposal:

Transitional cost	Cost (£000)			
	Year 1	Year 2	Year 3	Total
Temporary additional resources	900	600	300	<b>1,800</b>
Investment requirement	1,000	800	600	<b>2,400</b>
<b>Total</b>	<b>1,900</b>	<b>1,400</b>	<b>900</b>	<b>4,200</b>

The benefit and cost model is intended as a guide only at this stage in the development of the HPST proposal. The following table summarises the net cash flow position for each year:

Cash flow (+ = benefit, - = cost)	Benefit / Cost (£000)			
	Year 1	Year 2	Year 3	Total
Benefits	+1,150	+2,250	+3,350	+6,750
Transitional costs	-1,900	-1,400	-900	-4,200
<b>Total</b>	<b>-750</b>	<b>+850</b>	<b>+2,450</b>	<b>+2,550</b>

The above table summarising the potential cash flow is highly indicative at this stage, both in terms of quantum and profiling. The figures are thought to be realistic and prudent given experience of business transformation programmes in local government. A very cautious view has been taken in bringing PCT budgets into the model.

The table shows however that there would have to be a considerable reduction in potential benefits and / or increase in transitional costs over the indicative 3-year period for a net deficit to occur. The table above demonstrates that the financial benefits could be significantly more than the cost of delivering them, making this an attractive invest to save proposition providing there is a strong focus on benefits realisation.

### Financial summary

The emerging financial case demonstrates the advantages of the HPST proposal in terms of value for money. It also shows that the proposal is affordable. Ongoing savings will be derived through achieving economies of scale, avoidance of duplication, rationalisation of staffing structures over time, achieving synergies in service delivery and applying best practice from within

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the existing organisations. Benefits will arise from improved service delivery and will ensure better public services at a time when the growth in public spending is slowing down.

The key projections, given that the financial model is just a working hypothesis at this stage, are as follows:

- Potential savings building up to a figure in excess of £3 million a year;
- Potential savings maximised possibly by year three; and
- Potential transitional costs in the region of £4 million.

The cash resource released would be reinvested in the new organisation's priorities that will be informed by:

- The Local Area Agreement (LAA);
- Service improvement programmes in the Council's corporate plan;
- Service improvements in the PCT's Local Delivery Plan;
- Actions being taken by the Council to address audit or inspection recommendations;
- Actions being taken by the PCT to address audit or inspection recommendations; and
- Development plans for Section 31 services.

The Planning, Commissioning and Performance Management Working Group is drafting a set of organisational priorities for the HPST for further consideration. Once this piece of work has been completed, it will be possible to assess how much cash resource can be released into each emerging priority.