

# Full Business Case

Argyll and Bute Council

Charitable Leisure & Libraries Trust

11 October 2016

Ernst & Young LLP



**EY**

Building a better  
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Donald MacVicar  
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11 October 2016

Dear Donald

**Full Business Case exploring the implementation of a Leisure and Libraries Trust**

In accordance with our consultancyONE letter of appointment signed on 3 May 2016, we have prepared our Full Business Case exploring the implementation of a Charitable Leisure and Libraries Trust.

**Purpose of our report and restrictions on its use**

This report was prepared on your instructions solely for the purpose of Argyll and Bute Council and should not be relied upon for any other purpose. Because others may seek to use it for different purposes, this report should not be quoted, referred to or shown to any other parties unless so required by court order or a regulatory authority, without our prior consent in writing. In carrying out our work and preparing our report, we have worked solely on the instructions of Argyll and Bute Council and for its purposes.

Our report may not have considered issues relevant to any third parties. Any use such third parties may choose to make of our report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use. This report should not be provided to any third parties without our prior approval and without them recognising in writing that we assume no responsibility or liability whatsoever to them in respect of the contents of our deliverables.

**Scope of our work**

Our work in connection with this assignment is of a different nature to that of an audit. Our report to you is based on inquiries of, and discussions with, management. We have not sought to verify the accuracy of the data or the information and explanations provided by management. If you would like to clarify any aspect of this review or discuss other related matters then please do not hesitate to contact us.

Yours sincerely



Philip Milne  
Partner

## Abbreviations

B/NB/PE	The Business/Non-Business/Partial Exemption calculation
CBA	Cost Benefit Analysis
Charitable Trust	Charitable Leisure and Libraries Trust
CEO	Chief Executive Officer
FBC	Full Business Case
FCA	Financial Conduct Authority
GVA	Gross Value Add
IPS	Industrial and Providential Society
KPI	Key Performance Indicator
NDR	Non Domestic Rates
NPV	Net Present Value
OBC	Outline Business Case
OSCR	Office of Scottish Charity Regulator
SCIO	Scottish Charity Incorporated Organisation
SLA	Service Level Agreement
SOA	Single Outcome Agreement
SOC	Strategic Outline Case
SORP	Statement of Recommended Practice
SPF	Strathclyde Pension Fund
The Council	Argyll and Bute Council
TUPE	Transfer of Undertakings
VAT	Value Added Tax

## Executive summary

Argyll and Bute Council (the Council) appointed EY to assist on the development of a Full Business Case (FBC) to explore a range of service transformation options within its Leisure and Libraries Service. This will focus on the creation of a Charitable Leisure and Libraries Trust (Charitable Trust), which the Council agreed to pursue and investigate in February 2016.

The FBC is structured as follows:

- ▶ Strategic Case – To confirm the strategic fit and business needs within the context of the Council.
- ▶ Economic Case – To demonstrate the options that were identified, the appraisal process undertaken and to identify the preferred option.
- ▶ Commercial Case – To set out the commercial implications in areas of corporate structure, governance, contractual arrangements and staffing considerations.
- ▶ Financial Case – To set out affordability implications of the preferred option.
- ▶ Management Case – To describe the approach to implementation of the preferred option, demonstrating the project is achievable and can be delivered successfully.

## Strategic Case for Change

Like all Local Authorities across Scotland, the Council is facing significant budgetary pressures that continues to increase on an annual basis. Delivering these services through a Charitable Trust creates the opportunity for a new delivery model that can help to reduce these pressures on Council services.

This route is well established in Scotland, with only a handful of the 32 Local Authorities not adopting this approach. By reviewing the extent of the possible Non Domestic Rates (NDR) and Value Added Tax (VAT) savings and understanding the opportunities for improving the delivery of these services, there is the expectation that the provision of these services in a more efficient manner will reduce the financial burden on the Council.

Additionally, the Council identified a number of key benefits associated with the transfer of services to a Charitable Trust, namely:

- ▶ A single focused body with clarity of outcomes
- ▶ Independence and the ability to diversify
- ▶ Less bureaucracy and greater speed of decision making
- ▶ Increased access to other funding streams
- ▶ Ability to react quickly to market forces
- ▶ VAT and NDR savings
- ▶ Commercial revenue growth
- ▶ Improved financial performance
- ▶ Sustainability of service provision.

The Council service choices programme concluded that the transfer of the Leisure and Library Services creates the opportunity for an efficient and commercially driven approach with a view of driving further financial and non-financial benefits.

## **Economic Case**

The Council identified an initial long list of options for the future provision of the leisure and library services. These were:

1. Status Quo
2. Transfer Halls to community ownership
3. Outsourcing Leisure Services to community enterprises
4. Outsourcing to an existing Charitable Trust

The Council discounted pursuing the transfer of some of the services to community ownership or to community enterprises. These were seen to be impractical and did not address the strategic pressures facing these services.

For this reason, and based on the precedent set by other Councils across the UK, a full options appraisal analysis has not been carried out. As a result, the Economic Case reviewed the qualitative benefits of the following two options:

- ▶ Continuing to operate the services under the status quo
- ▶ Transfer the leisure and library services to a Charitable Trust.

The outcome of the qualitative assessment of options has highlighted that the creation of Charitable Trust is the preferred option for the Leisure and Library Services. The key drivers for changing the current delivery model to that of a Charitable Trust include:

- ▶ The potential ability to use savings for reinvestment into the services and assets.
- ▶ The ability to hire new skills and focus on the commerciality of the services available, allowing them to adapt and quality to improve going forward
- ▶ The Council sets the strategic direction, provides oversight and ensures the Trust's objectives and operational performance are aligned to the Council through its KPI regime.

## **Cost Benefit Analysis**

A Cost Benefit Analysis of the two options has been undertaken. This demonstrates that the net benefit across a 25 year period was indicatively estimated at £8.6m in Net Present Value (NPV) terms

This financial benefit is the result of VAT and NDR savings against the additional costs of running the Charitable Trust. These savings are unlocked with the selection of the Charitable Trust as the preferred delivery option

In order to deliver these benefits the commercial issues and risks must be robustly managed and a clear financial position established by way of a Business Plan for the new entity.

## **Commercial Case**

With regards to the Corporate Structure, three options were identified with the ability to achieve charitable status:

1. Company Limited by Guarantee
2. Scottish Charity Incorporated Organisation (SCIO)
3. Industrial and Provident Society (IPS)

The recommended option is, similar to many other Local Authorities, for a Company Limited by Guarantee. The structure offers the protection and familiarity of the Companies Act, supported by clear and established legal precedents over the rights and obligations placed on Board Members.

Office of the Scottish Charity Regulator (OSCR) guidance mandates that the Charitable Trust Board be made up of a minority of Council Elected Members and a majority of independent representatives. A number of trusts have chosen to include an additional representative from the Trade Unions. The Chair would be an independent representative elected by the Board itself. In addition, there could be representatives from the Council Officers who would act as observers on the Board.

The Board member roles will be clearly defined in the Articles of Association and the recruitment of the Board should be designed to ensure an optimal mix of skills and experience. A formal strategic risk mitigation strategy will be regularly undertaken by the Board and its Chief Officer.

The relationship between the Council and the Charitable Trust would cover the following areas:

- ▶ Lease Agreements – ownership of the building assets will be retained by the Council and will be leased or licenced to the Charitable Trust.
- ▶ Service Level Agreements (SLA) – the Charitable Trust will require a range of support and administration services which it will initially procure from the Council under a number of SLAs, commonly at nil cost.
- ▶ Operating Agreement – sets out the terms of the Management Agreement between the Charitable Trust and the Council and includes the range of Key Performance Indicators (KPI) and the Management Fee.
- ▶ Management Fee – the Council would pay for the services of the Charitable Trust in the form of a Management Fee. This would initially be set at a rate reflecting the operational net expenditure gap transferring to the Charitable Trust but would be expected to reduce over time as the Charitable Trust improves the service offering, drives revenue and achieves operational efficiencies.

The FBC recognises that the appropriate management of staffing issues will be critical to the successful establishment and operation of the Charitable Trust. Transfer of Undertakings (TUPE) legislation will apply to staff.

## **Financial Case**

The Financial Case identified the following

- ▶ Savings from VAT and NDR
- ▶ Additional costs incurred by adopting a Charitable Trust
- ▶ Projected Outturn of Charitable Trust in the first year

## Savings from VAT and NDR

The preferred option will allow the Council to realise a significant Financial Savings. These savings are driven from the treatment of VAT and relief from NDR. As the Charitable Trust will have a charitable status, certain income it generates will be exempt from VAT purposes and this provides VAT savings to the Charitable Trust. The Council is currently required to charge VAT on the provision of these services, whereas the Charitable Trust will be able to treat the provision of the service as exempt for VAT purposes. The savings arise where the price charged to customers remains unchanged and the Charitable Trust is able to retain a portion of the income that the Council had to charge and account for as VAT.

Together the estimate for potential NDR savings for the first year are in the range of £0.572m and £0.702m. For the purposes of this analysis, we have applied a prudent assumption of £0.636m

## Additional Costs

A new Charitable Trust would incur costs during the initial transition. These are likely to range from £0.205m and £0.295m for expenditure such as office set up costs, legal costs, media, website and marketing. These costs will be met from existing Council resources and will therefore not be a Year 1 cost for the Trust. Additionally the Charitable Trust would incur a range of recurring annual costs. Recurring costs can range from £0.095m to £0.185m, and relate to costs such as legal, audit, marketing and insurance.

## Charitable Trust: Projected Outturn

The table below includes the projected outturn of adopting a Charitable Trust.

### Charitable Trust: Projected Year 1 Position (£000)

	Base position	Non-cash items adjustment	Recurring costs	NDR Saving	VAT Saving	Year 1
<b>Income</b>	<b>(2,077)</b>	-	-	-	-	<b>(2,077)</b>
Accounting Adjustments	1,571	(1,571)	-	-	-	-
Employee Expenses	4,107	-	-	-	-	<b>4,107</b>
Premises Related Expenditure	1,845	-	-	-	-	<b>1,845</b>
Supplies & Services	697	-	95	-	-	<b>792</b>
Support Services and Departmental Admin Charges	1,283	-	-	-	-	<b>1,283</b>
Third Party Payments	243	-	-	-	-	<b>243</b>
Transport Related Expenditure	160	-	-	-	-	<b>160</b>
NDR and VAT Savings	-	-	-	(540)	(96)	<b>(636)</b>
<b>Total Expenditure</b>	<b>9,905</b>	<b>(1,571)</b>	<b>95</b>	<b>(540)</b>	<b>(96)</b>	<b>7,794</b>
<b>Deficit</b>	<b>7,828</b>	<b>(1,571)</b>	<b>95</b>	<b>(540)</b>	<b>(96)</b>	<b>5,716</b>

Source: Argyll and Bute Council Management Accounts & EY assumptions

In year 1 the estimated management fee payable by the Council to the Charitable Trust is £5.716m.

## Management Case

To ensure the successful delivery of the Charitable Trust, the Council should develop a detailed Project Plan, setting out the tasks and time frame for implementation. These include:

- ▶ Confirmation of the underlying assets and package of services being proposed for transfer.
- ▶ Future approach to the maintenance and repairs of the Charitable Trust assets, and to capital expenditure requirements.
- ▶ Recruitment and training of both a Chief Executive Officer (CEO) and Shadow Board Members.
- ▶ Addressing the financial and administrative implications of setting up a Charitable Trust.

However, there are a number of statutory and regulatory issues that are expected to take longer to implement and should therefore be considered, these are:

- ▶ OSCR application process
- ▶ Her Majesty Revenue and Customs (HMRC) discussions on Tax matters
- ▶ Completing the TUPE transfer process.

The project will continue to be supported by strong Governance, with the Project Team reporting to the Project Board and with decisions on further approval to be made by the full Council. Effective risk management will continue through monitoring and updating the Risk Register. A suitable Contingency Plan to continue with the current service model is available, should unforeseen issues delay the implementation of the Charitable Trust.

Throughout this process regular communication with Elected Members, Council employees and service users will be essential.

## Next Steps

We would expect that the following key next steps be undertaken:

- ▶ **Commercial case**
  - ▶ Confirm the preferred approach to the Charitable Trust's legal structure.
  - ▶ Undertake Shadow Board recruitment and review Governance Arrangements.
  - ▶ Develop legal documentation including Lease Agreements, SLAs and Management Agreement.
  - ▶ Confirm approach for the provision of support services, maintenance and utilities.
- ▶ **Financial case**
  - ▶ Review the base financial position and reflect on any further amendments to this position.
  - ▶ Refine transition and recurring costs.
- ▶ **Management case**
  - ▶ Develop robust and comprehensive Project Plan.
  - ▶ Begin dialogue with OSCR and HMRC.
  - ▶ Agree Communication Strategy.



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# 1. Introduction

The Council appointed EY to assist on the development of a FBC to explore a range of service transformation options within its Leisure and Libraries Service. This will focus on the creation of a Charitable Trust, which the Council agreed to pursue and investigate in February 2016.

The purpose of this section is to present the approach and structure implemented in the FBC.

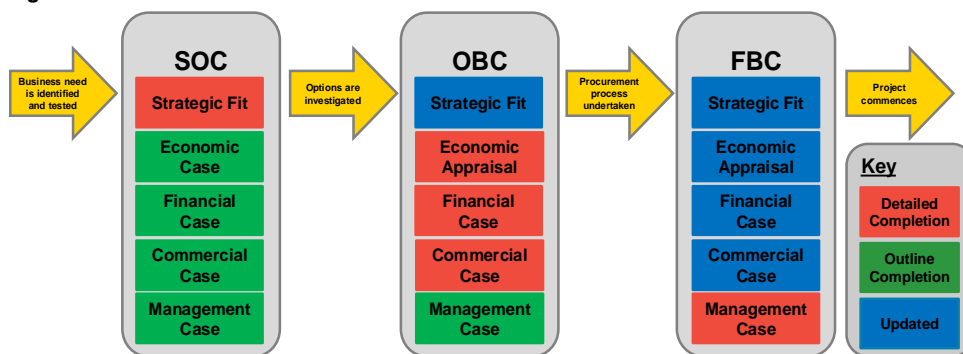
## 1.1 Approach to applying the five case model

The standard guidance requires business cases to be developed in three stages:

- ▶ Strategic Outline Case (SOC) – explore initial options
- ▶ Outline Business Case (OBC) – evaluate list of options
- ▶ FBC – develop the preferred option

This is illustrated in the following diagram:

Figure 1 - Standard five case model



Source: EY

This FBC presents a comprehensive review of the five cases, however, if the Council were to proceed with the implementation of the Charitable Trust, a final updated addendum may be desirable to capture the financial commercial and managerial position.

## 1.2 Structure of this report

The FBC is structured as follows:

- ▶ Strategic Case – To confirm the strategic fit and business needs within the context of the Council.
- ▶ Economic Case – To demonstrate the options that were identified, the appraisal process undertaken and to identify the preferred option.
- ▶ Commercial Case – To set out the commercial implications in areas of corporate structure, governance, contractual arrangements and staffing considerations.
- ▶ Financial Case – To set out affordability implications of the preferred option.
- ▶ Management Case – To describe the approach to implementation of the preferred option, demonstrating the project is achievable and can be delivered successfully.

Where appropriate, further detail on specific areas is contained in the appendices.

## 2. Strategic Case

### 2.1 Introduction

A Charitable Trust is an independent, arm's length external organisation, widely used by Local Authorities to operate a range of public services. Across the UK, local authorities are facing significant and sustained adjustments to their public sector funding. Charitable Trusts offer a range of financial and commercial benefits that can help to sustain the future of these services in light of the pressures on public spending.

The Council is exploring the future of their Leisure and Library Services and has identified a Charitable Trust as its preferred delivery option (See section 3 – Economic Case – for more information on this process).

The Strategic Case provides the strategic context behind the decision taken by the Council to review the model for the provision of the Leisure and Library Services. It provides background information on the Council and those services within scope for the Charitable Trust. Importantly, it also described the process pursued by the Council that justifies how the Strategic Case for change was established.

### 2.2 Background

Argyll and Bute is the second largest Council area in Scotland, covering almost 9% of the nation's total land area. It has the third lowest population density of all the Scottish Council areas. There are no large urban cities in the area but, there are a number of large towns including Helensburgh, Campbeltown, Dunoon, Oban, Lochgilphead and Rothesay. Populations in these towns range from over 2,500 to 15,000 people. This low population density is further complicated as nearly 20% of the population live on islands. As a result, a widespread population with no 'central' population base present a unique set of challenges for the Council in the manner in which it delivers its services.

The Council has developed a shared vision for the area. This vision is summarised in the Single Outcome Agreement (SOA), namely: *Argyll and Bute's Economic success is built on a growing population*. This vision has six key outcomes:

1. *Our economy is diverse and thriving*
2. *We have an infrastructure that supports sustainable growth*
3. *Education skills and training maximise opportunities for all*
4. *Children and young people have the best possible start*
5. *People live active, healthier and independent lives*
6. *People will live in safer and stronger communities.*

The Council provides a broad range of statutory and non-statutory services to local residents. The cost of these services are broken down in the table below:

**Table 1 - 2014/15 annual cost of service (net)**

	2014/15 £'m	2015/16 £'m
Education	104.6	123.1
Social work	61.9	66.1
Environmental	21.7	18.2
Roads and Transport	18.5	18.0
Cultural and Related	10.4	10.9
Housing (Non-HRA)	6.2	7.8
Planning and Development	5.1	6.3
Other	11.0	12.9
<b>Total</b>	<b>239.4</b>	<b>263.3</b>

Source: Argyll and Bute Council – Annual Accounts for the year ended 31 March 2015 and 31 March 2016 (unaudited)

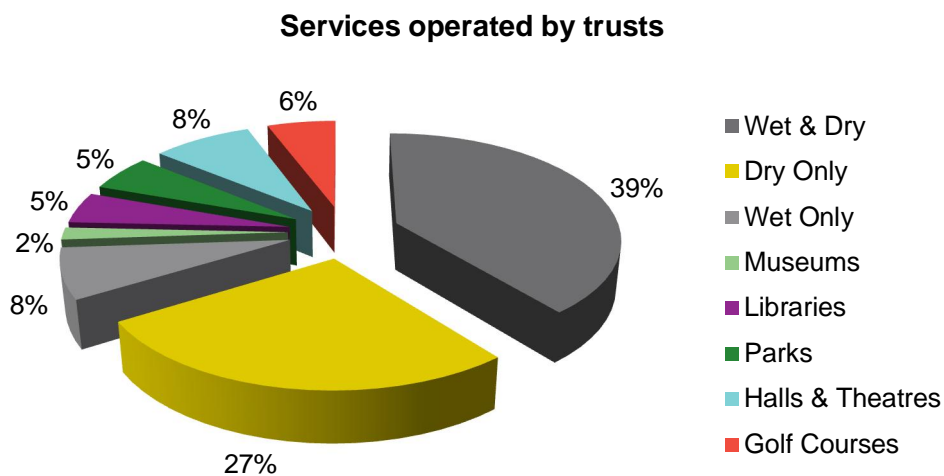
The cost of these services in 2014/15 was £239.4m and £263.3m in 2015/16. This represents a 10% increase in the cost of services in 2015/16, a trend that is difficult to sustain in light of significant budgetary pressures facing the Council and other Councils across Scotland. This trend is further exacerbated when the Scottish Government announced that there would be a further 3.5% cut to local government revenues for 2016/17. This sharpens the focus of local government funding and the future of the Leisure and Library Services for Argyll and Bute.

The 'Cultural and Related' services cost of £10.4m represent approximately 4.1% of the total cost of the total Council services in 2015/16. This constitutes a significant proportion of the services proposed for transfer, as well as a number of playing fields and parks that will remain under Council control. A small proportion of the assets earmarked for transfer are accounted for under the "Education" category.

### 2.3 Services proposed to be delivered by the Charitable Trust

The extent of the services delivered by a Charitable Trust can be wide ranging. The chart below illustrates the percentages of facilities managed by trusts in England, Wales and Scotland, based on a 2010 survey of 34 Charitable Trusts.

**Figure 2 - services operated by trusts**



Source: Winckworth Sherwood "Trusts for Big Society" (2010)

The survey highlights that the largest proportion of Charitable Trusts contains wet and/or dry facilities, i.e. leisure facilities contain swimming pools and other leisure facilities. However, there is a growing trend for Charitable Trusts to operate a wider portfolio of services, including

halls, theatres and libraries. For this reason, the Council is not only exploring the transfer of leisure services, but also a range of libraries, halls and community centres.

The current service provision is split into a number of different areas, namely, leisure (both wet and dry), community halls and libraries.

### **2.3.1 Leisure Services**

The Leisure Services within the Council consist of a number of swimming pools and fitness facilities, providing services to customers across the area. The facilities transferring to the Charitable Trust include:

- ▶ Aqualibrium
- ▶ Helensburgh Pool
- ▶ Riverside Leisure Centre
- ▶ Rothesay Leisure Pool
- ▶ Mid Argyll Sports Centre

The Atlantis Leisure Centre in Oban is run as a social enterprise. Whilst it receives an annual grant from the Council, it is operated independently by the local community and is therefore not included within the scope of services for the transfer to the Charitable Trust.

These leisure facilities provide customers with accessible and professional services. The services aim to help improve the overall health, fitness and general wellbeing of the community in order to assist the Council in realising its full potential while achieving best value for their customers. These are used extensively and are a valued part of the community.

### **2.3.2 Halls and Community Centres**

There are nine community halls and centres operated by the Council. These are:

- ▶ Queens Hall – Dunoon
- ▶ Victoria Hall – Campbeltown
- ▶ Victoria Halls – Helensburgh
- ▶ Ramsay Hall
- ▶ Corran Halls
- ▶ Kintyre Community Education Centre
- ▶ Lochgilphead Community Centre
- ▶ Dunoon Community Centre
- ▶ Moat Centre – Rothesay

These range from small village halls, such as Islay's Ramsay Hall, to large music and cultural venues like Dunoon's Queens Hall. The halls provide a range of community, health and tourism services for the local communities.

### 2.3.3 Libraries

The Council provides a free and comprehensive library services to the area. This includes:

- ▶ Eleven libraries within Campbeltown, Cardross, Dunoon, Helensburgh, Lochgilphead, Oban, Rosneath, Rothesay, Tarbert, Tobermory and Tiree
- ▶ A library headquarters
- ▶ One mobile library vehicle.

It provides a range of extensive service to people of all ages and social backgrounds. Services include, access to a wide range of lending materials; promoting learning and development programmes to encourage reading and promote literacy; supporting those in education or undertaking research and providing free internet and wireless access in all libraries. Library facilities are increasingly being used as a community hub by a wide range of local groups.

## 2.4 Financial position of the assets

In the year 2015/16 Leisure and Library Services recorded a net deficit of £7.828m, summarised below.

**Table 2: Annual Leisure, Library and other community services Financial Position 2015/16**

	Leisure £'000	Libraries £'000	Halls and other community services £000	Total £'000
Income	1,176	117	784	2,077
Expenditure	(5,230)	(2,141)	(2,486)	(9,905)
<b>Total Surplus / (Deficit)</b>	<b>(4,054)</b>	<b>(2,024)</b>	<b>(1,701)</b>	<b>(7,828)</b>

*Source: Argyll and Bute Council*

The combined service generated £2.077m in income and cost £9.905m to run.

The Council, like a number of Local Authorities, is seeking to review alternative methods for providing Leisure and Library Services to the local community. This focus is driven by the fiscal pressures the Local Government sector continues to face and the increased demands on resources. As such, there is a need to establish delivery models that can provide more sustainable services. Reviewing the provision of the Leisure and Library Services was viewed as one possible mechanism to help achieve these savings.

## 2.5 Strategic Case for Change

Maintaining the quality of these services in the future is challenging. The Leisure and Library Services require ongoing maintenance to sustain standards. Additionally customer expectations are on the rise and complying with health and safety standards is paramount. Maintaining or increasing current income levels with a reducing and ageing population presents a significant challenge to the service. Additionally, undertaking marketing and promotion of venues is proving difficult in an increasingly competitive environment.

During the summer of 2015, information was presented to Elected Members' Service Choices working group outlining options for sustaining the level of Leisure and Library Services provided by the Council. This summarised the budgetary pressures facing the Council and introduced a different proposal to explore the implementation of a Charitable Trust.

In recent years, the Council has undertaken a number of cost savings reviews:

- ▶ In February 2011, a review of the Culture, Leisure and Libraries Service targeted savings of £509k (an 11.6% budget reduction). These savings were targeted over a two year period until April 2013.
- ▶ In February 2013, a further saving of 3.9% was targeted for the financial year 13/14.

Over both of these reviews, staff savings were identified and restructuring took place, particularly at a management level where a leaner structure was implemented. Other efficiency savings were adopted, for example, adjusting service opening hours. At this stage, it was decided that the transfer of Leisure and Library Services to a Charitable Trust would not be brought forward.

During the 2015/16 Service Choices process, the option to transfer community halls, swimming pools and fitness facilities to a Charitable Trust was re-examined. The Council undertook an in-house review of potential savings and concluded that up to £500k of NDR savings could be made (potential VAT savings were not quantified). To meet any further savings target it was identified that price increases and a review of opening hours would be amongst the options required. This high level estimate was viewed as an initial benchmark of best case savings it could expect to make.

Additionally, the Council identified a number of key benefits associated with the transfer of services to a Charitable Trust, namely:

- ▶ A single focused body with clarity of outcomes
- ▶ Independence and the ability to diversify
- ▶ Less bureaucracy and greater speed of decision making
- ▶ Increased access to other funding streams
- ▶ Ability to react quickly to market forces
- ▶ VAT and NDR savings
- ▶ Commercial revenue growth
- ▶ Improved financial performance
- ▶ Sustainability of service provision.

The Council report concluded that the transfer of the Leisure and Library Services creates the opportunity for an efficient and commercially driven approach with a view to driving further financial and non-financial benefits. Further information on the appraisal process is described in section 3.

## 2.6 Summary

Like all Local Authorities across Scotland, the Council is facing significant budgetary pressures that continues to increase on an annual basis. These pressures are exacerbated, particularly within the Leisure and Library Services, when there is an expectation that these services need to improve to satisfy growing customer expectations.

Delivering these services through a Charitable Trust creates the opportunity for a new delivery model that can help to reduce these pressures on the Council's services. This route is well established in Scotland, with only a handful of the 32 Local Authorities not adopting this approach. By reviewing the extent of the possible NDR and VAT savings and understanding the opportunities for improving the delivery of these services, there is the expectation that the provision of these services in a more efficient manner will reduce the financial burden on the Council.

## 3. Economic Case

### 3.1 Introduction

The purpose of the Economic Case is to develop our understanding and establish the value for money comparison of two shortlisted options:

1. Continuing with the existing model of service provision
2. Transfer to a Charitable Trust.

This will be demonstrated through a qualitative assessment of the options and a cost-benefit analysis of the Charitable Trust to demonstrate value for money.

### 3.2 Description of the delivery models

The Council identified an initial long list of options for the future provision of the Leisure and Library Services. These were:

**Table 3 - Short list of options**

Option	Description
<b>Status Quo</b>	Under the status quo, the existing arrangements would remain the same. The Council would continue to provide the services as part of its current remit.
<b>Transfer Halls to community ownership</b>	With the exception of Rothesay Pavilion, all community halls would be owned and operated by the local community.
<b>Outsource leisure services to community enterprises</b>	Outsource leisure services, through a series of SLA's to community enterprises including MACpool, MacTaggart Leisure Centre and Atlantis Leisure.
<b>Outsource to a Charitable Trust</b>	Under this option, the services would be transferred to a wholly owned, not-for-profit Charitable Trust.

*Source: Argyll and Bute Council*

The Council discounted pursuing the transfer of some of the services to community ownership or to community enterprises. These were seen to be impractical and did not address the strategic pressures facing these services.

Additionally, a further option was discounted that involved implementing individual Charitable Trusts on a geographical basis. There are significant logistical and financial drawbacks associated with setting up separate entities to manage individual assets. Any economies of scale associated with a central entity would be lost and the significant additional financial costs would likely outweigh any expected financial savings. Additionally, there may be deliverability problems associated with hiring the appropriate number of independent members with the necessary skills and experience for multiple trusts.

For this reason, and based on the precedent set by other Councils across the UK, a full options appraisal analysis has not been carried out. As a result, the Economic Case will review the qualitative benefits of the following two options:

- ▶ Continuing to operate the services under the status quo
- ▶ Transfer the Leisure and Library services to a Charitable Trust.



### 3.2.1 Operate the services based on the status quo

Under the option, the Leisure and Library Services would continue to run as fully integrated services delivered by the Council. Like all Council services, they will be subject to the same budgetary pressures and expected spending.

There are a number of perceived advantages and disadvantages of operating the assets as the status quo.

**Table 4 - Advantages and disadvantages of the status quo**

<b>Advantages</b>	<p>There is the opportunity to have direct control over the strategic direction of the services</p> <p>It is unlikely that there would be any political or reputational impact resulting from changing the way these services operate</p>
<b>Disadvantages</b>	<p>There is an inability to adapt to future spending pressures</p> <p>Expected reduction in frontline services due to the ongoing public sector funding cuts</p> <p>There is limited opportunity to improve the commercial offering and deliver an enhanced service due to funding constraints.</p> <p>Providing a clear strategy and vision for these services may not be a priority in the face of pressures on other Council services.</p> <p>Increased probability of reduced opening hour or price increases, given the budgetary pressures.</p> <p>Limited access to further or private sector funding</p> <p>Unable to benefit from NDR or VAT savings</p>

*Source: EY Analysis*

### 3.2.2 Leisure and Libraries Trust

A Charitable Trust is a not-for-profit organisation set up by a local authority to manage a range of cultural and leisure facilities. A Charitable Trust of this type is run as a separate charitable company from the Local Authority with a Governance Board made up of Elected Members, employees and Community Representatives.

The creation of a Charitable Trust is a well-established delivery model, with a significant range of benefits over the status quo. In Scotland, a significant number of Local Authorities have developed Charitable Trusts for the management of their leisure and/or culture services with the size, scale and detailed operation varying depending on each council's circumstances.

As a Charitable Body, the trust can take advantage of savings on NDR. Additionally, as the Charitable Trust will have a charitable status, certain income it generates will be exempt for VAT purposes and therefore will provide partial exemption VAT savings.

The majority of leisure and library facilities require subsidy to a greater or lesser degree, so it is normal for Local Authorities to fund the operating deficit by way of a management charge which represents the cost of the Charitable Trust providing services on behalf of the Council.

Contrary to public opinion, Charitable Trust status is not a form of privatisation. The Council retains control and ownership of the assets and, being the main funder, has continuing major influence over policy.

From an operational perspective, the Charitable Trust would deliver the services through the existing staff base who would transfer from the Council to the trust on the basis of TUPE from the Council to the Charitable Trust. The structural changes associated with the development of a Charitable Trust have a number of potential advantages to the Council. The table below provides a summary of the relative advantages and disadvantages:

**Table 5 - Advantages and disadvantages of a Charitable Trust**

<b>Advantages</b>	<p>Less bureaucracy and greater speed of decision-making</p> <p>Improved management structure and the ability to incorporate greater levels of commercial acumen and entrepreneurial flair.</p> <p>Increased access to small and other charitable funding streams</p> <p>The ability to leverage VAT and NDR savings</p> <p>Independence and ability to diversify</p> <p>Increased community involvement in the decision-making process</p> <p>Increased prospect of additional funding sources such as National Lottery Funding or private funding</p>
<b>Disadvantages</b>	<p>Less direct Council control over the strategic direction of these services</p> <p>Without adequate communication, there is the potential for political or reputation ramifications if the transfer of services is negatively construed.</p>

*Source: EY Analysis*

There are clear and wide ranging benefits to the creation of a Charitable Trust.

### 3.3 Cost Benefit Analysis

The outcome of the qualitative assessment of the options has highlighted that the significant advantages offered by the transfer to a new charitable organisation makes it the preferred option. In the paragraphs below we have conducted a Cost Benefit Analysis (CBA) against the status quo to consider the value for money implications of implementing the new delivery model. Costs and revenues are analysed further in the Financial Case.

The analysis is calculated using the Net Present Value of the costs and benefits. This discounts the value of a future cash flow back to present terms. This accounts for the impact of inflation and other financial impacts on cashflows.

#### 3.3.1 Costs

The creation of the new Charitable Trust would result in additional running costs and one off transition costs which will need to be taken into consideration when analysing against the base case. These costs have been estimated as:

- ▶ Transition costs – between £0.205m and £0.295m
- ▶ Recurring costs – between £0.095m and £0.185m.

These costs ranges are based on EY's experience of other Leisure Trusts and the Council's own view of likely costs. For more information on the makeup of these costs, see section 5. For the purpose of the CBA we adopted the upper end of the range for the transition costs and the lower end of the range for recurring costs. This reflects the Council's view on the expected costs.

#### 3.3.2 Benefits

The CBA considers two main areas of financial benefits – NDR and VAT.

##### 3.3.2.1 NDR

The NDR savings assume that the Charitable Trust will be a registered charity and that the application to OSCR for charitable status will be approved. The detailed NDR savings are set out the Financial Case.

##### 3.3.2.2 VAT

It is expected that the Charitable Trust will have a charitable status and consequently certain income it generates will be exempt for VAT purposes under the VAT Sporting Services and Culture Services exemptions, and this can provide VAT savings to the Charitable Trust. The Financial Case details the approach to calculation of VAT savings.

### 3.3.2.3 Operational Efficiency Savings

As part of moving to a Charitable Trust model, there is the potential to realise a level of operational savings driven from either an increase in revenues and /or a reduction in costs. This is based on the track record of other similar Charitable Trusts. However, these savings are not guaranteed and at this stage of the business case process, have not yet been developed. For the purpose of this CBA, to ensure a prudent result, no efficiency savings have been factored into the analysis.

### 3.3.2.4 Additional local and national economic benefits

The final aspect to be considered in a CBA is the local and national benefits arising from the change in the service delivery such as additional jobs and Gross Value Added (GVA) to the economy. The FBC is based on the continued delivery of a set of services and accordingly we consider there to be no additionality between the options, in both terms of direct and indirect GVA to the economy.

## 3.3.3 Analysis of Costs and Benefits

The following table summarises the CBA calculation associated with the transfer to a charitable organisation compared to the status quo. The analysis has been undertaken over 25 years due to the long term nature of the assets under review, applying the HM Treasury Green Book discount rate of 3.5% real. For further details on the calculations can be found at Appendix A.

**Table 6: Cost Benefit Analysis: 25 years**

	Nominal Operational Annual Charge (£'000s)	Nominal Total (£'000s)	Net Present Value (NPV) (£'000s)
Cost	95	2,670	1,851
Benefit	636	15,900	10,482
<b>Net Benefit</b>	<b>541</b>	<b>13,230</b>	<b>8,631</b>

Source: EY Analysis

The results of the CBA show that setting up the Charitable Trust shows clear net benefit of £8.6m in NPV terms over 25 years in comparison to the current position and £3.2m in nominal terms. A levelised annual benefit in nominal terms is estimated at £0.541m per annum reflecting the net gain from the NDR and VAT savings and additional costs of the Charitable Trust delivery structure. The CBA results are indicative and will be subject to a detailed business planning process should the Council proceed with implementing the Charitable Trust model.

In the above analysis, no optimism bias has been included. This is deemed appropriate due to the following reasons:

- ▶ **Costs:** The figures being used for the costs have been calculated based on benchmarking to the current market against similar sized Charitable Trusts in Scotland.
- ▶ **Benefits:** The only benefits which have been included in our analysis relate to tax and NDR efficiencies, these have been calculated based on the current tax laws and therefore deemed to be factual and no bias adjustment is required. It has not taken into account potential operation efficiencies or the potential for increased commercial return.

Sensitivity analysis has been carried out on the length of time included in the NPV calculation and the probability of realising the full tax efficiencies. There is no adjustment to cost in this analysis. These have been selected as possible scenarios if the tax rules are changed, therefore a short term NPV analysis should be reviewed to ensure it still has a positive net benefit. These have been summarised in the table below:

**Table 7: Sensitivity Analysis**

Sensitivity of NDR and VAT savings	5 year NPV (£'000s)	10 year NPV (£'000s)	25 year NPV (£'000s)
100% Probability	2,157	4,214	8,631
80% Probability	1,583	3,156	6,535
60% Probability	1,008	2,098	4,438

Source: EY Analysis

The results show that there is a projected positive net benefit in all the scenarios within a range £1m and £8.6m. No efficiency savings are assumed for the purpose of the CBA.

The CBA supports the qualitative assessment preferred option of the charitable organisation by providing a tangible net benefit in financial terms.

### 3.4 Summary

The Economic Case has highlighted that the creation of Charitable Trust is the preferred option for the delivery of the Leisure and Library services. The key drivers for changing the current delivery model to that of a Charitable Trust include:

- ▶ The potential ability to use savings for reinvestment into the services and assets.
- ▶ The ability to hire new skills and focus on the commerciality of the services available, allowing them to adapt and quality to improve going forward
- ▶ The Council sets the strategic direction, provides oversight and ensures the Trust's objectives and operational performance are aligned to the Council through its KPI regime

When compared against the status quo, the Charitable Trust demonstrates value for money:

- ▶ The net benefit across a 25 year period was indicatively estimated at £8.6m in NPV terms
- ▶ This financial benefit is the result of VAT and NDR savings against the additional costs of running the Charitable Trust. These savings are unlocked with the selection of the Charitable Trust as the preferred delivery option.

The option of establishing the Charitable Trust is now progressed to the financial, commercial and management cases in the remaining sections of this report.

## 4. Commercial Case

### 4.1 Introduction

In this case, a number of different considerations regarding the future commercial and operating structure of the Charitable Trust will be developed.

The purpose of this section is to:

- ▶ Develop analysis regarding important commercial and operating considerations for the Charitable Trust.

The assessment will be informed by:

- ▶ A discussion regarding the Charitable Trust structure, Governance and Commercial Arrangements
- ▶ A description of the issues related to the provision for support services and repairs and maintenance arrangements
- ▶ Regulatory and staffing arrangements

### 4.2 Charitable trust structure

The key issues to consider on formation of the Charitable Trust are:

- ▶ The type of charitable organisation to set up
- ▶ The type of corporate structure to choose
- ▶ Registration and ongoing regulation formalities of the charity.

#### 4.2.1 Options

There are a number of different options typically considered for Charitable Trusts, for example:

1. Company Limited by Guarantee
2. SCIO
3. IPS

These are examined below.

#### 4.2.2 Option 1: Company Limited by Guarantee

A Company Limited by Guarantee is the most common structure usually employed when creating a new charity. The key features of this structure include:

- ▶ It is incorporated under the Companies Act 2006 without issuing shares but instead the Member guarantees a sum of money in the event of insolvency (typically £1)
- ▶ It gives the company, and its Members, limited liability in respect of the debts and obligations of the company
- ▶ The Directors have duties and responsibilities under the Companies Acts and additional duties as trustees once the company is a registered charity

- ▶ It is regulated by both the Companies Act and OSCR.

After incorporation, an application to OSCR will be made to obtain charitable status. Once the Charitable Trust is formed it would enter into a number of agreements with the Council including the Leases/Licences, the SLA and the Operating Agreement. The directors will have to comply with both the requirements of the Companies Act and OSCR.

There are a number of advantages to this option:

- ▶ Protection and familiarity of the Companies Act.
- ▶ Supported by clear and established legal precedents over the rights and obligations placed over the member of the board.

However, there are disadvantages of this structure, such as:

- ▶ Separate registration is required under Companies Act and under OSCR requirements.
- ▶ Reporting requirements apply under both regulatory regimes.
- ▶ Board members act as Directors under Companies Act and as Trustees under OSCR regulations.

#### **4.2.3 Option 2: Scottish Charity Incorporated Organisation**

The SCIO is a new legal form of charity available in Scotland which was introduced in April 2011. As with a Company Limited by Guarantee, the SCIO is a corporate body and so can hold property and enter into contracts in its own name. The members of the SCIO also have the benefit of limited liability.

The purpose of the SCIO was to create a corporate model that is specifically tailored to the requirements of the charity sector and allows charities access to the benefit of limited liability whilst simplifying the regulatory framework. The key features of this structure include:

- ▶ OSCR is responsible for granting both charitable status and a corporate identity at the same time
- ▶ SCIOs are governed solely by Scottish Charity legislation and not governed by the Companies Act.

The benefits of a SCIO when compared with a Company Limited by Guarantee are considered to be:

- ▶ A simpler registration process in relation to charitable status and incorporation, as OSCR grants charitable status and a corporate identity simultaneously
- ▶ A simpler regulatory regime, as the reporting requirements are those that apply to Scottish charities and avoids reporting to both Companies House and OSCR
- ▶ The legal framework governing SCIOs is simpler in comparison
- ▶ The duties of charity trustees have been simplified, so the trustees are only subject to the requirements of Scottish charities legislation.

However, there are disadvantages of a SCIO structure, such as:

- ▶ A key downside of the SCIO is that it is not incorporated under the Companies Act and therefore is not afforded the same legislative protection. Similarly, the SCIO is a new structure and the processes required for certain circumstances may not have precedent to rely upon.

- ▶ A SCIO must have at least two members, which differs from the company structure, which only requires a sole member. In practice, this means the Council will need to set up a nominee company to constitute the second member. The SCIO's constitution can be drafted so that the Council has the sole power to appoint the board. Additional administration would be required to set up a nominee company but, thereafter, the ongoing administration should be minimal as the nominee company would not be active.
- ▶ The application to register a SCIO must be made by at least two individuals and not corporate bodies. The Council, and the nominee company, would be admitted as members at a later point. This can be accommodated by having provisions in the Charitable Trust constitution, stating that as soon as the Council and the nominee company are admitted as members, the two initial individual members, cease to be members.
- ▶ SCIOs can be removed from the Scottish charity register by OSCR, which would automatically prompt the entity to cease as a corporate body. Conversely, if a company limited by guarantee is removed from the Scottish charity register there would be no effect on it continuing to exist as a legal entity. Practically, it would be highly unlikely that OSCR would proceed with the dissolution of a SCIO without first carrying out detailed enquiries and without having compelling reason for taking such action.
- ▶ A SCIO is unable to grant a floating charge security over its assets. SCIOs are, however, able to grant fixed charges securities over assets, such as land or buildings, similar to a company. Typically, this is not a problem as all the Charitable Trust's major assets would be owned by the council and leased to the Charitable Trust.

#### **4.2.4 Option 3: Industrial and Provident Society**

An IPS is similar to a company but is governed by different legislation and is incorporated through the Financial Conduct Authority (FCA) rather than under the Companies Act. IPSs can be used for charitable purposes provided they can demonstrate they are for "community benefit". The key features of an IPS structure include:

- ▶ Registered under the Industrial & Provident Societies Act 1965
- ▶ Corporate bodies with limited liability
- ▶ Qualify for registration if conducting a business or trade established for the benefit of the community.

The IPS legislative framework and registration system do, however, lag behind company law. From a structural perspective, it offers no advantages over a Company Limited by Guarantee or SCIO structure and, as such, is rarely used by local authorities developing a Charitable Trust.

#### **4.2.5 Other considerations - Charitable Trading Subsidiary**

Irrespective of which option is chosen, it is anticipated that the Charitable Trust will require a Charitable Trading Subsidiary to undertake all non-primary purpose activities. These include all activities that do not fall squarely within the charitable objectives of the organisation (e.g. bar, café and rental of business spaces).

The Council should note that the creation of a Charitable Trading Subsidiary may result in additional burden on the financial and legal work streams. This should be considered prior to implementation.

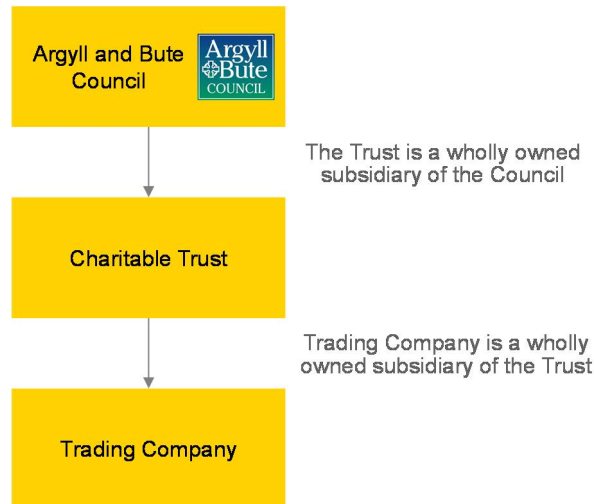
#### **4.2.6 Recommendation**

Local Authorities would commonly adopt a Company Limited by Guarantee status as well as the Charitable Trading Subsidiary. The structure offers the protection and familiarity of the

Companies Act, supported by clear and established legal precedents over the rights and obligations placed on the members of the Board.

An organisational structure that adopts this approach is defined in the following diagram.

Figure 3 - Proposed organisation structure



Source: EY

### 4.3 Charitable Trust board and governance

As part of the future governance structure of the Charitable Trust, the size and structure of the board of directors should be established. A detailed discussion of these points is contained within Appendix B. The following narrative highlights the commonly adopted principles.

OSCR guidance mandates that the Charitable Trust Board be made up of a minority of Council Elected Members and a majority of independent representatives. We would recommend that the board is made up of seven individuals. Three of these would be elected members, with the remaining four independent members making up the majority. A number of Trusts have chosen to include an additional representative from the Trade Unions. The Chair would be an independent representative elected by the Board itself. In addition, there could be representatives from the Council Officers who would act as observers on the board. We anticipate that these positions would be voluntary, however, it is likely that a small budget will be needed to compensate board members for expenses.

The recruitment of the board should be designed to ensure an optimal mix of skills and experience. If the Council takes the decision to proceed with the Trust, there would be value in exploring implementing the recruitment process as early as possible. The board would normally be recruited prior to the go live date of the Charitable Trust and will therefore act as a “shadow” board between recruitment and commencement of operations. An illustrative skills matrix showing the desirable attributes is shown in Appendix C based on EY’s experience of what works well elsewhere.

### 4.4 Council and Charitable Trust: Commercial Arrangements

The relationship between the Council and the Charitable Trust would have its basis through a number of contractual documents:

- ▶ Lease Agreements – ownership of the building assets will be retained by the Council and will be leased or licenced to the Charitable Trust.



- ▶ SLA – the Charitable Trust will require a range of support and administration services which it will initially procure from the Council under a number of SLAs, commonly at nil cost.
- ▶ Operating Agreement – sets out the terms of the management agreement between the Charitable Trust and the Council and includes the range of KPI's and the Management Fee.
- ▶ Management Fee – The Financial Case demonstrates that the operations being transferred to the Charitable Trust operate with a net expenditure which would require external funding for the Charitable Trust to be financially viable. Consequently, the Council would pay for the services of the Charitable Trust in the form of a management charge. This would initially be set at a rate reflecting the operational net expenditure gap transferring to the Charitable Trust but would be expected to reduce over time as the Charitable Trust improves the service offering, drives revenue and achieves operational efficiencies.

Despite the contractual basis of the relationship between the Council and the Charitable Trust, it is important that the Charitable Trust is supported by the Council, particularly in the early years and so the Charitable Trust must be set up in such a way that the advantages of its arms-length structure and charitable status are maximised.

#### 4.4.1 Support Services

The provision of support services to the Charitable Trust is another important consideration. It is expected that these services will encapsulate a number of different services including HR, Finance and Legal services.

There are different service delivery options for the provision of support services.

- ▶ Council retains control - the responsibility for delivering these services may be retained by the Council. All services are provided to the Charitable Trust for nil cost. There are a number of financial benefits from adopting this position, developed in the financial case.
- ▶ Control transfer to the Charitable Trust - alternatively, there are also significant commercial advantages for passing on responsibility of these services to the Charitable Trust. The Charitable Trust may decide to continue to utilise Council services for an agreed fee. Alternatively, it may also look to third party providers or hire their own specialist support.

There is also the option to adopt a hybrid approach where the Trust retains control for elements of the support service, while larger support roles are retained by the Council. For example, it may be beneficial for the Trust to have control over some finance and HR functions.

There are also legal implications when deciding who should retain responsibility for these services. For this reason, we recommend that the Council work with their legal advisors on this matter.

#### 4.4.2 Maintenance Options

One of the key aspects of a Charitable Trust is that the Council retains ownership of the assets. Therefore, it is in the interest of the Council to maintain these assets. Other authorities have deemed it prudent to commit a portion of the expected annual NDR/VAT savings to a planned maintenance regime. This helps to bring the assets to standard base condition and would allow them to improve over time.

The initial maintenance options are based on whether the maintenance is supplied by the Council to the Charitable Trust or procured directly by the Charitable Trust:

- ▶ **Option 1: Council delivery.** All necessary capital and maintenance works are delivered through the Council for no charge to the Charitable Trust. This approach allows the Council to reclaim the VAT incurred on the related expenditure where it relates to the

Council’s non-business activities. In this scenario, where the Council does not charge the Charitable Trust for these works there is no direct effect on the Management Fee.

- **Option 2: Charitable Trust delivery.** If the Charitable Trust is given responsibility for all necessary capital and maintenance works this would mean that the Charitable Trust would incur expenditure and accordingly would require the payment of a higher management fee from the council to the Charitable Trust to balance the income and (higher) expenditure. The Charitable Trust will not be in a position to reclaim all the VAT incurred on the spend.

The advantages and disadvantages of the two different maintenance options are shown in the following table:

**Table 8 - Advantages and disadvantages of maintenance options**

Option	Advantages	Disadvantages
<b>Option 1:</b> Maintenance responsibility is retained within the Council	The Council can reclaim the VAT on capital expenditure.	Charitable Trust does not have control of its own maintenance regime and cannot act independently.
<b>Option 2:</b> Maintenance responsibility is transferred to the Charitable Trust	Charitable Trust has control of its own maintenance regime and can operate independently of the Council. Other advantages of this approach include; flexibility, prioritisation of repairs and the ability to adapt to changing customer demand.	The Charitable Trust is liable for the VAT and cannot reclaim the VAT in full.

Source: EY analysis

The implications of Option 2 are that the Charitable Trust will suffer a partial VAT cost on any capital works or repairs and maintenance obligations. Where the Charitable Trust has a VAT recovery position of 50% recovery this will result in a 10% VAT cost.

Typically, we would see a Charitable Trust and council reaching agreement that the responsibility for repairs and maintenance is shared. In this circumstance, the Charitable Trust is normally responsible for minor works up to a pre-agreed council limit, for example £5,000. This allows the Trust to benefit from the advantages noted above, for example, carrying out basic repairs (such as repairs to lighting) without having to approach the council every time repairs of this nature are required. Using this agreement, the Council remains responsible for large capital expenditure and therefore limits irrecoverable VAT.

This is particularly relevant if the Charitable Trust wants to invest in significant amounts of capital works or asset enhancement. If this responsibility sits with the Charitable Trust, there could be significant VAT liabilities arising on large value investments. The Council should consider reviewing the asset base, undertake stock condition surveys and start to consider how these arrangements will form part of any management arrangements.

The Charitable Trust may be able to procure external contractors at a more competitive rate reducing the price differential, subject to compliance with procurement rules and so allowing the Charitable Trust to have control of its maintenance regime may be achievable without a material financial impact on the Council.

If the preferred option is approved by the Council, a decision on the approach to maintenance delivery and funding would be required during the development phase.

### 4.4.3 Key Performance Indicators

The Charitable Trust should measure, monitor and analyse performance in order to ensure best practice and the highest levels of delivery. The Council has an established framework of performance indicators that help to align and quantify the strategic priorities of its services. The Council has developed its service plans which capture all the relevant service KPI’s. These are organised within corporate themes, and includes KPI’s such as “*Raised lifelong*

*participation levels in sport and physical activity to enable us to lead more active healthier lives”, which would continue to be relevant to the Trust.*

The Charitable Trust should also have a process in place that allows management to monitor progress. The use of KPIs is critical to this process as they are:

- ▶ A powerful tool which ensures an improving standard of delivery
- ▶ A means of actively measuring customer and employee satisfaction
- ▶ Enables the Council to measure and appraise the Charitable Trust based on performance

The KPIs are used to ensure the progress of the Charitable Trust by actively managing and communicating with customers, staff, management and the Charitable Trust Board. It should form part of the formal management reporting including:

- ▶ Monthly overview by Charitable Trust Board
- ▶ Periodic Council meetings
- ▶ An Annual Report for the Council

The monitoring of KPIs should be linked to a Continuous Improvement Plan and reflected in the Charitable Trust Business Plan, setting out commitments to continuous improvement and targets that offer positive benefits. It should be reviewed annually in line with the Charitable Trust Business Plan.

Where performance is below target, or can be improved, the Charitable Trust should be required to develop action plans to be implemented and monitored to improve identified areas of weakness/improvement. This is particularly important as a number of Local Authorities that have recently implemented Charitable Trusts have undertaken benefit realisation exercises post implementation to review the success of the process.

During the preparation of the Business Plan, the Charitable Trust and the Council would agree a suitable set of KPI's with which to measure performance.

## **4.5 Staffing considerations**

The role of staff will be critical to the successful establishment and operation of the Charitable Trust. Staffing issues such as TUPE and pensions will need to be appropriately managed.

### **4.5.1 Transfer of Undertakings**

With the creation of the Charitable Trust, there are TUPE (Protection of Employment) implications for the Council. All staff wholly or mainly assigned to the “transferable role” will move to the Charitable Trust.

Staff will transfer with their existing terms and conditions of employment under TUPE. This includes:

- ▶ Current salary
- ▶ Hours of work
- ▶ Sick Pay
- ▶ Continuous service

- ▶ Annual leave and public holiday entitlement
- ▶ Working hours as per employment contract

If the Council was to approve the implementation of the Charitable Trust, obtaining legal advice on this area will be essential.

#### **4.5.2 Pensions**

The Charitable Trust will apply to be given admitted body status within the Strathclyde Pension Fund (SPF). This would enable Charitable Trust employees to continue to participate in the Local Government Pension Scheme with no changes to pension provision and full service protection.

By entering SPF as an admitted body, the Charitable Trust would be committing to all terms that need to be met by the employer. SPF has a structured process that the Council and Charitable Trust will need to follow before any firm commitment can be given and this process can take between three and six months.

As far as we are aware all other councils who have set up a Charitable Trust have been successful in achieving admitted body status.

We have not included any additional employer pension contributions expenses. Employer contribution rates will be determined by the Pension Fund's actuary. These rates will be reassessed on periodic basis, as determined by the pension fund agreement between the Trust, SPF and the Council. In our experience with other local authorities, there have been no significant changes to the employer pension contribution expenses from moving to this new model. However, we're aware that if the Council was to proceed with the Charitable Trust, a significant number of employees would be effected. As such, it would be prudent for the Council to further refine all likely recurring costs during the implementation process (if approved).

### **4.6 Summary**

This section has set out the commercial case of applying a Charitable Trust structure as the model to deliver Leisure and Library Services.

The structural options for the Charitable Trust were set out and the recommendation is that a Company Limited by Guarantee be used. This company would have a Board of Directors comprising Elected Members and Independent Members, with an Independent Member taking the Chair. The main Commercial Arrangements between the Council and the Charitable Trust would cover areas such as a lease arrangement (ensuring the ownership of assets remains with the Council), SLA and operational agreements and setting a Management Fee.

The appropriate management of staffing issues will be critical to the successful establishment and operation of the Charitable Trust.

The Management Case considers how these issues should be taken forward as part of the wider project management and planning approach.

## 5. Financial Case

### 5.1 Introduction

The Financial Case has been prepared to present the projected year one financial position for the Charitable Trust. It has been prepared in line with the following underlying assumptions.

- ▶ The financial position for the Leisure and Library Services for the year 2015/16
- ▶ Adjustments to the 2015/16 financial position to reflect specific expected actual financial position of the Charitable Trust in year one
- ▶ A review of the expected NDR and VAT savings from these services.

### 5.2 Financial Position for FY15/16

To understand the potential financial advantages of the Council creating a Charitable Trust, a baseline financial position has been established. This is based on the 2015/16 financial information for the Leisure and Library Services. The financial position is set out below.

**Table 9: Annual Leisure, Library and other community services Financial Position 2015/16**

	Leisure £'000	Libraries £'000	Halls and other community services £000	Total £'000
Income	<b>(1,176)</b>	<b>(117)</b>	<b>(784)</b>	<b>(2,077)</b>
Accounting Adjustments	732	190	649	1,571
Employee Expenses	2,373	912	823	4,107
Premises Related Expenditure	1,076	274	495	1,845
Supplies & Services	309	303	85	697
Support Services and Departmental Admin Charges	687	334	262	1,283
Third Party Payments	68	21	154	243
Transport Related Expenditure	35	107	19	160
Expenditure	<b>5,279</b>	<b>2,141</b>	<b>2,486</b>	<b>9,905</b>
<b>Total (Surplus) / Deficit</b>	<b>4,103</b>	<b>2,024</b>	<b>1,701</b>	<b>7,828</b>

Source: Argyll and Bute Council

The analysis highlights that the combined assets have income of £2.077m and costs of £9.905m. This results in a net deficit of £7.828m.

### 5.3 Charitable Trust: Projected year one financial position

The first year of trading of the Charitable Trust will reflect a number of adjustments from the financial position in 2015/16. These adjustments reflect the following factors:

- ▶ Removal of non-cash items in order to establish the underlying operational performance excluding accountancy adjustments such as depreciation.
- ▶ Inclusion of additional costs in respect of the new Charitable Trust structure:
  - ▶ One off transition costs for setting up the Charitable Trust
  - ▶ Recurring annual operational costs

- ▶ Recognition of the savings generated by the Charitable Trust in respect of NDR and VAT.
- ▶ A full list of all the financial assumptions is contained in Appendix D.

**Table 10: Charitable Trust: Projected Outturn Year 1**

	Base position	Non-cash items adjustment	Recurring costs	NDR Saving	VAT Saving	Year 1
<b>Income</b>	<b>(2,077)</b>	-	-	-	-	<b>(2,077)</b>
Accounting Adjustments	1,571	(1,571)	-	-	-	-
Employee Expenses	4,107	-	-	-	-	<b>4,107</b>
Premises Related Expenditure	1,845	-	-	-	-	<b>1,845</b>
Supplies & Services	697	-	95	-	-	<b>792</b>
Support Services and Departmental Admin Charges	1,283	-	-	-	-	<b>1,283</b>
Third Party Payments	243	-	-	-	-	<b>243</b>
Transport Related Expenditure	160	-	-	-	-	<b>160</b>
NDR and VAT Savings	-	-	-	(540)	(96)	<b>(636)</b>
<b>Total Expenditure</b>	<b>9,905</b>	<b>(1,571)</b>	<b>95</b>	<b>(540)</b>	<b>(96)</b>	<b>7,794</b>
<b>Deficit</b>	<b>7,828</b>	<b>(1,571)</b>	<b>95</b>	<b>(540)</b>	<b>(96)</b>	<b>5,716</b>

Source: Argyll and Bute Council Management Accounts & EY assumptions

The overall impact of making these adjustments is to project an underlying deficit of £5.716m. There are a number of significant observations that this analysis presents:

Our analysis indicates that there will be an annual net saving of £0.541m when accounting for the recurring costs (this is the difference between the annual NDR and VAT savings and the annual recurring costs).

### 5.3.1 Adjustment for non-cash items

An adjustment has been made for all the non-cash items in the analysis. This provides an indication of the underlying cash position from service operations. It separates out the impact of accountancy adjustments such as depreciation from the operational performance. This approach allows the Council to understand how the financial position drives the requirement for a management fee from the Trust which is based on operation performance. Historical debt costs would remain as a corporate cost to the Council.

Adjustments have been made for staff costs of £1.571m.

### 5.3.2 Transition costs

The new Charitable Trust is likely to incur a range of one-off transition costs. These will be incurred during the process of establishing the Trust in the first year. The costs have already been included in the Council's revenue budget. As such, the Trust will not be responsible for incurring these costs out of its first year budget. These costs are likely to include:

- ▶ All IT costs associated with a new website, equipment and other consumables
- ▶ Marketing, branding and communication strategy
- ▶ Other office set up costs

- ▶ Corporate Governance costs – costs including company registration, trustee insurance and shadow Board Governance training
- ▶ Council advisory costs - financial and legal advisor costs.
- ▶ Staff costs including recruitment expenses and relocation costs etc.

Based on our experience of costs associated with similar Trust's in the past, we have identified the following range of costs:

**Table 11 - transition costs**

Category	Low	High
	£000	£000
IT	25	45
Marketing, branding and communication	50	75
Other office set up costs	5	15
Corporate governance costs	5	10
Council advisory costs	110	130
Staff costs	10	20
<b>Total</b>	<b>205</b>	<b>295</b>

Source: EY

The Council has taken a prudent position and modelled the high range of costs in the Financial Case.

Our analysis indicates that there will be an initial payback period of six months for the first year transition costs when compared against the NDR and VAT savings currently available.

### 5.3.3 Ongoing recurring costs

In addition to the one-off transition costs, the Trust is also likely to incur recurring annual costs. A range of costs have been shown in the table below:

**Table 12 - recurring costs**

Category	Range	
	Low £000	High £000
Marketing	20	50
External Auditors	10	20
Legal and Regulatory costs	10	30
Trustee Expenses (insurance, expenses, recruitment)	5	10
Management Structure	50	75
<b>Total</b>	<b>95</b>	<b>185</b>

Source: EY

Unlike the transition costs, the recurring costs have been modelled at the lower range.

### 5.3.4 NDR and VAT Savings

The VAT position has been modelled based on a range of savings depending on the acceptance by HMRC of the proposed approach. It is critical that the VAT position is agreed with HMRC as soon as possible as it is not possible to provide certainty on the potential VAT savings until HMRC has confirmed its approval to the proposed arrangements. The underlying assumptions for each scenario have been summarised below:

**Table 13: Summary of differences between cases**

Responsibility For	Scenario 1	Scenario 2	Scenario 3
Utilities	Trust	Council	Trust
Repairs & Maintenance	Trust	Council	Trust
Support Services	Council	Council	Trust

Source: EY VAT Analysis

We have modelled the analysis to present a range of potential savings scenarios for the Charitable Trust.

Where utilities, repairs and maintenance and support services are the responsibility of the Trust, this limits VAT savings by increasing irrecoverable VAT. VAT savings increase where responsibility for utilities, repairs and maintenance or support services remain with the Council.

Where a service is provided by the Council, it is expected the costs will be incurred by the Council whilst the benefit from these services will be transferred to the Charitable Trust for nil consideration. When the service is incurred directly by the Trust for a consideration, the Trust is expected to meet the costs of these services internally.

The VAT savings are calculated by using the Council's actual figures from 2015/16. The analysis has been based on the VAT treatment of income and expenditure provided by the Council and subsequent discussions with the Council's finance officers.

The three scenarios can be described as follows:

- ▶ Scenario 1 – A prudent case for NDR and VAT savings
- ▶ Scenario 2 – An upside sensitivity.
- ▶ Scenario 3 – A downside sensitivity

A breakdown of the range of possible annual NDR and VAT savings of these options is included in the following table along with an indication of additional Trust related costs:

#### 5.3.4.1 Scenario 1

Scenario 1 calculates that the total NDR and VAT savings are £0.636m. This is based on the Charitable Trust incurring costs for repairs and maintenance and utilities while the Council provides support services for no charge.



**Table 14: Scenario 1 (£000)**

	NDR Savings	VAT Savings	Irrecoverable VAT	Total
Archives	-	-	-	-
Community Lettings	-	7	(3)	4
Sports Programmes	-	-	-	-
Community Centres & Halls	127	22	(12)	137
Libraries	132	-	(39)	93
Sports Facilities	281	206	(84)	403
<b>Total</b>	<b>540</b>	<b>235</b>	<b>(139)</b>	<b>636</b>

Source: EY VAT Analysis

### 5.3.4.2 Scenario 2

Scenario 2 calculates that the total NDR and VAT savings are £0.702m. This is based on the assumption that the Council takes responsibility for repairs, maintenance, utilities and support services associated with the Trust's assets. It then provides the services to the Charitable Trust for no charge. This outcome will be pursued by the Project Board in order to maximise potential savings. However, as this position has not been agreed with HMRC, scenario 1 (the prudent position) has been modelled in financial case.

**Table 15: Scenario 2 (£000)**

	NDR	VAT savings	Irrecoverable VAT	Total
Archives	-	-	-	-
Community Lettings	-	7	(3)	4
Sports Programmes	-	-	-	-
Community Centres & Halls	127	22	(8)	141
Libraries	132	-	(37)	95
Sports Facilities	281	206	(25)	462
<b>Total</b>	<b>540</b>	<b>235</b>	<b>(73)</b>	<b>702</b>

Source: EY VAT Analysis

### 5.3.4.3 Scenario 3

The down side scenario calculates that the total NDR and VAT savings is £0.572m. This is based on the assumption that the Trust contracts out the repairs, maintenance, support services and the utilities services. As a result, they would only be partially recoverable for VAT purposes.

**Table 16: Scenario 3 (£000)**

	NDR	VAT savings	Irrecoverable VAT	Total
Archives	-	-	-	-
Community Lettings	-	7	(5)	2
Sports Programmes	-	-	-	-
Community Centres & Halls	127	22	(17)	132
Libraries	132	-	(71)	61
Sports Facilities	281	206	(110)	377
<b>Total</b>	<b>540</b>	<b>235</b>	<b>(203)</b>	<b>572</b>

Note: Excludes risk allowance of £85,000, further detail on this is provided in the paragraph below.

Source: EY VAT Analysis

The savings shown in scenario 3 do not include the impact of HMRC refusing to accept that the management charge can be treated as notional taxable income for calculating VAT

recovery. We have not had experience of HMRC's refusal in this area, and there is case law (the cases of Edinburgh Leisure, South Lanarkshire Leisure and Renfrewshire Leisure - EDN 03/22, 03/29 and 03/30) which supports utilising the management charge as notional taxable income; however, this must specifically be agreed with HMRC. We estimate that the impact of this risk would be in the region of £0.085m.

#### 5.3.4.4 Summary

In summary, there are potential NDR and VAT savings ranging from £0.572m to £0.702m, with the prudent expectation being £0.636m.

#### 5.3.5 VAT savings

It is expected that the Charitable Trust will have charitable status and consequently certain income it generates will be exempt for VAT purposes under the VAT Sporting Services and Culture Services exemptions, and this can provide VAT savings in the Trust. The Council is currently required to charge VAT on the provision of these services, whereas the Trust should be able to treat the provision of the services as exempt for VAT purposes. The savings arise where the price charged to customers remains unchanged and the Trust is able to retain the portion of income that the Council had to charge and account for as VAT.

This can be best demonstrated with a simple example. The Council charges £5 for admission to swimming £5 includes 83p of VAT – the net receipt is £4.17. The Trust charges £5 for admission to swimming £5 is exempt from VAT – the net receipt is £5. Saving is 83p.

**Table 17: VAT Example**

VAT Example	£
<b>Status Quo</b>	
Admission for Swimming	£5.00
VAT Element (20%)	£0.83
<b>Net Receipt</b>	<b>£4.17</b>
<b>Charitable Trust</b>	
Admission for Swimming	£5.00
VAT (exempt)	£0.00
<b>Net Receipt</b>	<b>£5.00</b>
<b>Saving</b>	<b>£0.83</b>

Source: EY

Where the Charitable Trust provides services to the general public free of charge there will be non-business use of those assets. As the Charitable Trust does not benefit from the Council's s.33 VAT Act 1994 status, the Charitable Trust is required to restrict the proportion of the VAT it incurs on expenditure where it is not used for taxable business purposes. Where the Charitable Trust undertakes activities that are exempt from VAT, it will require the Trust to restrict a proportion of the VAT it incurs on expenditure.

The Business/Non-Business/Partial Exemption calculation (B/NB/PE) will determine how much VAT the Trust is entitled to reclaim. The restriction used for the purposes of the analysis is based on a combination of the Council's data and our experience of what Charitable Trusts will typically realise once they go live. Should the Council decide to proceed with a Charitable Trust, a sectorised B/NB/PE will be calculated and a position for the Charitable Trust as a whole will need to be agreed with HMRC.

Some sporting activities delivered by the Council are funded by grants as typically the users are not charged for the provision of the leisure service. The analysis has also been based on the Council continuing to receive the grant funding. The Council continues to act as the principal subcontracting the management and delivery of the relevant projects to the

Charitable Trust. Where this is the case the Charitable Trust will need to ensure the correct VAT treatment is applied to its supply of services to the Council. The VAT position will need to be considered on a case by case basis to determine whether it is a non-business grant arrangement or it should be treated as a taxable service.

### 5.3.6 Savings Identified

#### 5.3.6.1 Leisure

The VAT savings identified for leisure are based on the Charitable Trust being able to apply the VAT Sporting Services Exemption with no non-business use of the sports venues (with the exception of Oban Sport's Field).

The VAT savings identified for Leisure are based on the following income streams:

**Table 18: Income Streams**

Ref	Income Stream
62120	Club Bookings
62123	School Swimming Income
62128	Swimming Lesson Income
62129	Fitness Class Income
62140	Leisure Membership Fee
62141	Leisure General Admissions
62150	Hire Facilities
62172	Pitch Lets

Source: EY/Argyll and Bute Council

#### 5.3.6.2 Archives

There are no VAT savings associated with the Archives as there is no income associated with the Archives Centre. There will be no irrecoverable VAT cost for the Charitable Trust, as the Charitable Trust will manage the Archives service under a fully taxable SLA with the Council.

#### 5.3.6.3 Community Lettings

There are VAT savings in relation to the Community Lettings facility as the Council lets pitches which should qualify for the VAT Sporting Services Exemption with no non-business use of the venues.

There will be an additional irrecoverable VAT cost for the Charitable Trust, as the Charitable Trust is not entitled to recover VAT in relation to exempt activities.

There are no NDR savings in relation to these venues as these are not owned by the Council.

#### 5.3.6.4 Sports Programmes

There are no direct VAT savings achieved in relation to transferring the Sports Development services to Charitable Trust. There may be a wider operational benefit to transferring the services from a strategic fit perspective.

The transfer of the Sports Development service may improve the Charitable Trust's B/NB/PE position depending on the method agreed with HMRC as it could provide additional taxable income in the Charitable Trust where the Charitable Trust organises, manages and facilitates the delivery of the programme on behalf of the Council under a taxable service agreement with the Council.

Where Charitable Trust provides instruction, coaching or education services as part of this programme the VAT treatment of these services should be treated as exempt for VAT

purposes. This will result in an additional irrecoverable VAT cost for the Charitable Trust as the Charitable Trust is not entitled to recover VAT in relation to exempt or potentially non-business activities.

#### **5.3.6.5 Community Centre & Halls**

There may be VAT savings in relation to the Community Centre & Halls where the Charitable Trust undertakes performances which qualify for the VAT Culture Services Exemption. There are also VAT savings in relation to the letting of sporting facilities.

There will be an additional irrecoverable VAT cost for the Charitable Trust, as the Charitable Trust is not entitled to recover VAT in relation to exempt activities.

#### **5.3.6.6 Libraries**

There are no VAT savings associated with the libraries as they generate relatively little external income, the majority of which is taxable sales of books or outside the scope of VAT fines and grants. There will be an additional irrecoverable VAT cost for the Charitable Trust, as the Charitable Trust is not entitled to recover VAT in relation to non-business activities.

Please note that the Macmillan Project will be taxable as the Council will retain the grant funding and contract with the Charitable Trust to run the service

#### **5.3.6.7 Key Assumptions**

The VAT savings identified are dependent on confirming the VAT treatments applied with HMRC. This will be updated for the final business case addendum and business plan.

#### **5.3.7 NDR position**

We estimate that the Trust could realise NDR savings in the region of £0.540m per annum.

The NDR savings assume that the Trust will be a registered Charity and that the application to OSCR for charitable status will be approved.

The NDR savings are based on the total NDR costs for each venue discounted by the 5% discretionary relief that the Council will be required to fund.

The figures assume that the Trust is able to obtain the full 100% discretionary relief on each of the venues. To achieve this, the Trust needs to occupy the venue and it will need to be used *'wholly or mainly for charitable purposes'*.

Where the Trust is unable to obtain the 100% discretionary relief this will directly impact on the NDR savings that can be achieved. At this stage it is not possible to confirm whether or not the Charitable Trust will be able to achieve the 100% discretionary relief. This analysis is commonly undertaken during the implementation phase.

#### **5.3.7.1 Community Empowerment (Scotland) Act 2015**

The Community Empowerment (Scotland) Act allows Local Authorities to create localised NDR relief schemes. Local authorities are able to grant the relief to any type of ratepayer or for any reason, granted to a sole property, a street, a town centre or a particular type of business or sector. We understand that the Council has sought clarification on whether the legislation would allow the Council to benefit from the NDR savings without implementing a Charitable Trust. We recommend that advice on the application of this legislation is sought from a legal advisor. However, we have informally spoken with legal advisors and understand, however, that this is not the case.

Our understanding is that a Local Authority has to account to Scottish Government for the gross amount of NDR due (i.e. including any NDR the Council has elected to waive). As a result, there would be no net benefit to the Council. Additionally, the s140 discretion (in

accordance with the Act) could be challenged by way of judicial review. This would subsequently wipe out any gains accrued.

Furthermore, the legal view was that, if the Council were found to be giving rates relief to connected entities and not to others, this could be seen as an irrational or unlawful exercise of discretion. This is intensified due to the requirement to give regard to income/expenditure and taxpayer's interests when exercising their discretion. This could mean that a taxpayer's alliance group might have standing to raise a challenge as well as businesses who had not been granted relief.

By contrast, we consider that, the Charitable Trust approach is tried and tested and is based on a rationale that appears to be defensible.

#### **5.3.7.2 Key Assumptions**

The NDR savings identified are dependent on confirming the application of the 100% discretionary relief with the Rates Assessor. A specific area of focus for the Assessor will be those facilities with Dual Use, and an adverse outcome in this area could reduce the level of NDR savings. The treatment of these assets is therefore considered to be an area of financial risk. Ultimately the level of NDR savings should be agreed by the Rates Assessor.

#### **5.3.8 Capital expenditure**

The financial position highlighted above does not contain any depreciation expenses. A significant area of cash flow demand can be the need to incur substantial capital expenditure. Such expenditure is commonly excluded from the Management Fee paid by the Council to the Charitable Trust, accordingly separate arrangements are required. Such arrangements can include the Council incurring the expenditure or for the Charitable Trust to borrow and spend.

There are a number of planned capital projects that have not been adjusted for in the financial position. However, the future operating position of these assets should be considered when the Council is setting the management charge. These projects are:

- ▶ The landmark £18m leisure centre and swimming pool (including flood defences and public realm) in Helensburgh has not been included in this analysis. Given the long term nature of this project, it is considered prudent not to include the income, expenditure and possible NDR and VAR savings associated with this venue.
- ▶ Additionally, Queens Hall in Dunoon is currently undergoing an £8.5m refurbishment. For prudence, we have not adjusted the 15/16 actual position for any uplift in revenues or changes to underlying business rates.
- ▶ We have assumed that the Atlantis Leisure centre will continue to receive the grant funding it currently receives from the Council. This arrangement is not expected to be impacted by the implementation of a Charitable Trust.

#### **5.3.9 Other Exceptional Events**

There were a number of minor closures to leisure facilities during the year. However, we understand that there were no material exceptional events that would require the financial position to be adjusted.

### **5.4 Funding Strategy**

The Funding Strategy for the Trust covers two areas. Firstly, the ability to meet day-to-day revenue funding requirements, and secondly, delivering any capital funding needs. The revenue funding gap, identified as the net expenditure figure in section 5.3, would be met by the Council's Management Fee. Additionally, any capital funding requirements, for example any significant repairs or maintenance demands would be met by the Council's Capital Budget.

The Charitable Trust, however, presents the opportunity for the Trust to explore alternate funding streams that are less assessable to the Council. This may take the form of grants or donations, which would benefit from additional tax relief through the gift aid system. This will enhance the value of any donations. Although this income would not represent the majority of the Trust's income, other Charitable Trusts have seen their income supplemented in this way.

## 5.5 Summary

In this section, the base financial position of the future operating model has been established. The financial projections reflect:

- ▶ The 2015/16 financial outturn of £7.828m total net expenditure for the Leisure and Library Services.
- ▶ The first year financial position of the Charitable Trust has been established after making adjustments for recurring costs of £0.095m.
- ▶ We would also expect there to be transition costs in the region of £0.295m
- ▶ The Charitable Trust would be expected to make savings in respect of NDR and VAT of between £0.572m and £0.702m. For the purposes of this analysis we have applied a prudent assumption of £0.636m saving.
- ▶ The Charitable Trust Option therefore generates a first year operating deficit of £5.716m

## 6. Management Case

### 6.1 Introduction

The purpose of this section is to:

- ▶ Demonstrate that the implementation of the Charitable Trust is achievable and can be delivered successfully in accordance with accepted best practice.

The assessment will be informed by:

- ▶ The phase two Project Plan and Outline
- ▶ The proposed Governance Structure and legal implications
- ▶ The current Risk Register and proposed Communication Plan.

### 6.2 Project Plan

Once a decision is taken regarding the implementation of the Charitable Trust, a detailed Project Plan is required that identifies the key tasks and likely timescales needed for implementation.

Before the creation of a detailed Project Plan there are a number of statutory and regulatory issues that are expected to take longer and should therefore be considered. These are:

- ▶ Implementing and carrying out an effective communication process, both internally to Council employees and externally to end users, can take between four to six months to undertake. This will include Trade Union consultation.
- ▶ Developing legal documentation, including Lease Agreements, Management Agreements and Transfer and Service agreements, can take up to three months to complete.
- ▶ OSCR application and approval. Similar Charitable Trusts have taken up to six months for the OSCR application to be approved.
- ▶ Admissions to the Strathclyde Pension Fund. Given the structured process that the Council and Charitable Trust will need to follow before any firm commitment can be given, this process can take between three and six months.
- ▶ Preparation of a Trust Business Plan that captures all the decisions taken during this process and sets out the Trust's expected operating position.

Operational factors that require to be addressed include:

- ▶ Confirmation of the underlying assets and package of services being proposed for transfer.
- ▶ Future approach to the maintenance and repairs of the Charitable Trust assets, and to capital expenditure requirements.
- ▶ Recruitment and Training of CEO and Shadow Board Members. Including job advertisement, recruitment and training, this process would be expected to take a significant period of time. Given the prominence of the CEO's role and the likely notice period individuals may face prior to taking up this role, this process would take at a minimum three months.

- ▶ Addressing the financial and administrative implications of setting up a Charitable Trust. For example, in our experience setting up bank accounts for the Charitable Trust can take longer than expected, given the stringent “know your client” procedures banks have to undertake.

In our experience, we would expect that Brodies, as your specialist legal advisors, will provide assistance to the in house expertise with the following areas:

- ▶ Preparation of incorporation and constitutional documents
- ▶ Creation of Asset Lease Agreements
- ▶ Creation of SLA

Based on our experience working with other Local Authorities, implementation can take up to 9 - 12 months from the date of Council approval. A recent example would be Angus Council where the decision to approve the creation of a Charitable Trust was taken in December 2014. The Charitable Trust subsequently went live on the 1 December 2015.

The timetable should be developed if the Council proceeds to implement the Charitable Trust.

### **6.3 OSCR**

Upon incorporation, the new company would submit its application to OSCR for charitable status. A number of considerations must be taken into account before this application process begins:

- ▶ In order for the Charitable Trust to meet the ‘charity test’, it should ensure that it charitable objectives and goals in addition to providing benefits to the public.
- ▶ As the Charitable Trust will be run by a board that will include a majority of independent trustees, it will potentially result in a change of control for the council.
- ▶ Similar Charitable Trusts have typically taken up to six months for this application process to be approved. This should be factored into the project plan to ensure the Charitable Trust is established within an appropriate timeframe.

There are also additional financial and administration considerations for the Council that they must consider upon a successful OSCR application. A separate set of Charitable Trust charitable accounts must be produced that complies with the charities Statement of Recommended Practice (SORP). The Council must ensure that there are adequate in-house technical resources in place to produce these accounts, or consider the addition costs of outsourcing this service.

### **6.4 Risk Register**

The Project Team should develop and manage a detailed Risk Register for the Project. The effective identification, quantification and monitoring of risk is a critical part of effective project delivery.

### **6.5 Contingency plan**

Should a Charitable Trust not be implemented a Contingency Plan would be needed. This would be based on the current model continuing in its present format with the increased budgetary pressures that are likely to impact the future level of service provision.

### **6.6 Communication Plan**

Successful implementation of a new mode of service delivery will require clear and regular communications. These communications will be required with all stakeholders, including:



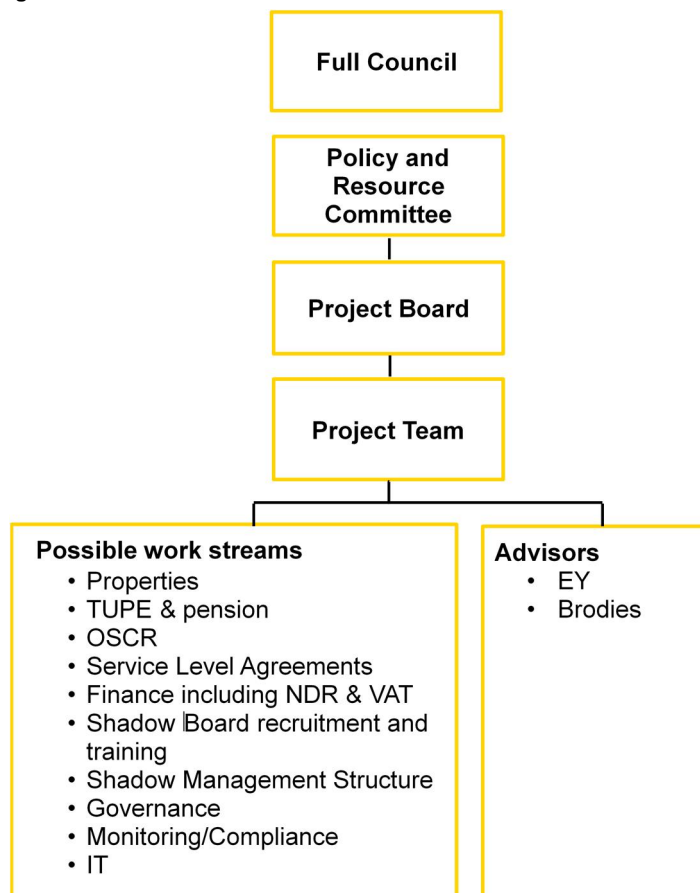
- ▶ Elected Members
- ▶ Council employees
- ▶ Service users

A Communications Plan will look to provide regular updates on progress and to allow stakeholders to raise questions with the Council. The Council is also likely to receive enquires from the media and accordingly the Press Team should be kept regularly briefed.

## 6.7 Governance Structure

The following Governance Structure illustrates the proposed involvement of the Council. The structure follows the best practice approach adopted to date, with a Project Team supported by advisors reporting to an overall Board and overseen by Full Council.

Figure 4 - Proposed governance structure



Source: EY

The Full Council will ultimately be responsible for approving the FBC to implement a new model of service provision.

## 6.8 Summary

The Management case has set out how the transfer to a Charitable Trust model of service delivery is achievable and can be delivered successfully. A number of factors that should be used to prepare a detailed Project Plan if the Council decides to approve the implementation of the Charitable Trust. This sets out a challenging set of tasks that will take a significant period of time to implement. We have highlighted tasks that will take a longer period, primarily regulatory activities associated with OSCR applications, discussions with HMRC on tax matters and meeting the requirements of TUPE legislation.

The Project will continue to be supported by strong Governance, with the Project Team reporting to the Project Board and with decisions on further approval to be made by the full Council. Effective risk management will continue through monitoring and updating the Risk Register. A suitable Contingency Plan to continue with the current service model is available, should unforeseen issues delay the implementation of the Charitable Trust.

Throughout this process regular communication with Elected Members, Council employees and service users will be essential.

## 6.9 Next Steps

Should the Council decide to approve the implementation of a Charitable Trust, there are a number of next steps that should be considered. A list of the time consuming tasks is noted in section 6.2. We would expect, however, that the following key next steps be undertaken:

- ▶ **Commercial case**
  - ▶ Confirm the preferred approach to the Charitable Trust's legal structure.
  - ▶ Undertake Shadow Board recruitment and review Governance Arrangements.
  - ▶ Develop legal documentation including Lease Agreements, SLAs and Management Fee.
  - ▶ Confirm approach for the provision of support services, maintenance and utilities.
- ▶ **Financial case**
  - ▶ Review the base financial position and reflect on any further amendments to this position.
  - ▶ Refine transition and recurring costs.
- ▶ **Management case**
  - ▶ Develop robust and comprehensive Project Plan.
  - ▶ Begin dialogue with OSCR and HMRC.
  - ▶ Agree communication strategy.

# Appendix A Cost Benefit Analysis

**Cost Benefit Analysis - Argyll and Bute Council**

Discount Rate	3.50%																												
	NPV 25	NPV 10	NPV 5	Total	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25
					£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
<b>Benefits</b>																													
NDR and VAT savings:	636	10,482	5,289	2,872	15,900	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636
Probability	0%	10,482	5,289	2,872	15,900	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636
Efficiencies		0	0	0	0																								
	10,482	5,289	2,872	15,900	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636	636
<b>Cost</b>																													
Additional Trust Costs	95	1,566	790	429	2,375	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95
One off costs		285	285	285	295	295	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
	1,851	1,075	714	2,670	390	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95	95
Net benefit		8,631	4,214	2,158	13,230	246	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541	541
Probability Sensivity																													
A - 0%		0%																											
B - 20%		20%																											
C - 40%		40%																											
Scenario in use	A - 0%																												
		25 year	10 Year	5 Year																									
A - 0%		8,631.48	4,214.26	2,157.62																									
A - 0%		8,631.48	4,214.26	2,157.62																									
B - 20%		6,535.03	3,156.39	1,583.30																									
C - 40%		4,438.58	2,098.51	1,008.99																									

## Appendix B Further board structure information

### Introduction

The Council is proposing to set up a Charitable Trust to deliver Leisure and Library Services. It is likely it will be the form of a Company Limited by Guarantee, which is registered as a Charity. This new company will require a separate Board of Directors/Trustees; these will come from one of the three categories:

- ▶ Elected Members of the Council;
- ▶ Officers of the Council;
- ▶ External from the council with the appropriate skills and interest.

This paper will discuss the required mix between the categories above. The Board would also have an appropriate skills mix; this is not considered here although is connected to the illustrative skills matrix at Appendix C.

These individuals will be company Directors in the terms of company law, and trustees for the purposes of charity law. In this paper, Directors will be used to capture both.

### Considerations

#### ***Conflict of interest***

It is likely that Directors will need to make decisions in situations where the interest of the company and those of the Council may not be aligned. This could give rise to a conflict of interest.

Both from a company law and charity law perspective, the Directors/Trustees must put the interests of the company first. If a board member cannot, then he or she must not take part in any discussion or decision on the matter.

On the other side of the equation, for Elected Members the Councillor's Code imposes the "duty to act in the interests of the council as a whole and all the communities serviced by it". This could create tensions for those Board Members who are Elected Members of the Council. The conflict rules could mean that Elected Council Members would be unable to participate in the decision making process.

As a result, if all the Directors had a relation to the Council the Board could cease to become functional. Therefore it is recommended that the board includes Directors who are independent from the Council.

On appointment of the Directors, it is important for them to fully understand their requirements and duties as a Director and be provided with training and guidance on how to handle any potential conflict of interest.

#### ***Size of the Trust Board***

There is no defined guidance for the Board size. It is considered important to have the correct balance between having enough appropriately skilled board members able to engage in meaningful debate, while not having overly large, unwieldy and inefficient board. There is no set pre-specified number of directors required and the number does not need be fixed for all time if experience shows that more or fewer directors would be preferable.

In our experience a Board of 7 would seem appropriate for the Charitable Trust on this occasion.

### ***OSCR guidance***

The Scottish charity regulator, OSCR, has specific guidelines on the type of individuals who should compose the Board. The key requirements from this guidance are: the majority of the Board Members should be independent of the Council; and, Governance Arrangements and Board Structure must allow the Board Members to fulfil their duties to the charity.

It is likely that these guidelines will be required to be complied when applying for charitable status. Where the Board comprises of seven members, it is recommended that the Board has four independent Directors to ensure an independent majority.

### ***Other governance routes***

Board representation is not the only way in which monitoring and Governance can be achieved. An additional Governance route for the Council relates to the appointment of observers to the board. The observers would be able to attend and speak at Board Meetings, but would not take part in decision making. This allows for additional Governance and monitoring at Board level while, crucially, maintains the integrity of the independent Board.

Other potential Governance routes could be: the Board being required to submit written reports to the Council on certain aspects of the company, for example the performance; and the legal agreement between the Council and the company would set out such requirement

### ***Council officers as Directors***

In the creation of the new Board, the Council would be free to nominate an Officer to be a Director, however, this is not commonly considered to be appropriate. Audit Scotland has concerns that the ongoing working activities of a Council officer impinge on clear roles and responsibilities between Council and Board duties. Accordingly, in order to monitor and examine the performance of the company, Council Officers can take an observer role on the Board.

### ***Initial recommendation***

Commonly, the following recommendations are applicable when determining the Board structure:

- ▶ A minority of Elected Members of the Council to be nominated to the Board;
- ▶ the Elected Members nominated are not those with a scrutiny and governance role from the Council side, and so are not, for example, Members of the Committee to which the company reports;
- ▶ A recruitment process to be conducted to identify a majority of independent candidates to fill the remainder of the posts on the Board, with the correct mix of skills. A potential candidate here may be a Trade Union representative;
- ▶ A limited number of Board observers who are Council officers;
- ▶ a detailed conflicts policy to be developed and embedded in the Governance Arrangements;
- ▶ Training on Board duties, including conflict issues to be provided, in due course, to the Board.

## Appendix C Illustrative Board Member Skills Matrix

Table 19 – Illustrative Board Member Skills Matrix

Board Member*	Behavioural		Governance			Technical				Industry				Comments
	Leadership	Communication	Previous Director experience	Community involvement	Strategic planning	Financial	Legal	HR	Comms / marketing	support for mission	fundraising	public policy	experience in sport / leisure / culture	
1. Elected Member														
2. Elected Member														
3. Elected Member/Independent Member														
4. Independent Member														
5. Independent Member														
6. Independent Member														
7. Independent Member														

**Scoring**

1	Low
2	Limited
3	Average
4	Strong
5	Very Strong

\*demographic mix: gender, age, ethnicity, demographic representative of local area

Source: EY

## Appendix D Financial and VAT Assumptions

### Key Assumptions

The VAT savings identified are based on EY's understanding of the Council's operations.

The VAT savings identified are dependent on confirming the VAT treatments applied with HMRC.

### Cultural Exemption

In order to be treated as an eligible body in relation to the cultural exemption the entity must satisfy the following conditions:

- ▶ is precluded from distributing, and does not distribute, any profit it makes;
- ▶ applies any profits made from supplies of cultural services to the continuance or improvement of the facilities made available by means of the supplies; and
- ▶ is managed and administered on a voluntary basis by persons who have no direct or indirect financial interest in its activities.

### Sporting Exemption

In order to be treated as an eligible non-profit-making entity for the purposes of the sporting exemption the entity must:

- ▶ have in its constitution restriction on the distribution of profits; and
- ▶ not be subject to either commercial influence or be part of a wider commercial undertaking.

### NDR Criteria

NDR relief is one of the biggest savings where the Council transfers leisure and cultural services into a charitable entity.

However, relief is only available where the entity is a registered Charitable Body with OSCR. A registered charity receives 80% mandatory relief from NDR and the Council may then award a further 20% discretionary relief to a charity that occupies premises wholly or mainly for charitable purposes.

It is the Council's responsibility to fund 25% of the 20% discretionary relief and thus we reduce 100% saving to 95% to reflect this.

### What are each of the cases?

**Table 20: Scenarios**

Responsibility For	Best Case	Prudent Case	Worst Case
Utilities	Council	Trust	Trust
Repairs & Maintenance	Council	Trust	Trust
Support Services	Council	Council	Trust

In the best case, we assume that:

- ▶ Utilities form part of the peppercorn lease from the Council to the Charitable Trust
- ▶ Repairs and maintenance form part of the peppercorn lease from the Council to the Charitable Trust
- ▶ Support services are provided by the Council to the Charitable Trust free of charge

In the prudent case, we assume that:

- ▶ The cost of utilities is borne by the Charitable Trust
- ▶ The cost of repairs and maintenance is borne by the Charitable Trust
- ▶ Support services are provided by the Council to the Charitable Trust free of charge

In the worst case, we assume that:

- ▶ The cost of utilities is borne by the Charitable Trust
- ▶ The cost of repairs and maintenance is borne by the Charitable Trust
- ▶ The cost of support services is borne by the Charitable Trust

***Calculation of non-business restriction risk***

Based on our experience with other Councils and Trusts, and existing case law, we have treated the Management Fee as notional taxable income on those activities which are mainly non-income generating, e.g. libraries, archives and Oban Sports Field for calculating VAT recovery.

Where HMRC do not accept this, there will be an additional irrecoverable VAT cost and this has been factored into the worst case modelling and the additional irrecoverable VAT would be £84,215.58.



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