



**Scottish Parliament
Finance Committee**

Preventative Spend – Call for Evidence

Evidence from ICAS

Due by 30 October 2015

About ICAS

1. ICAS welcomes this consultation and the opportunity to comment. We are a leading professional body for chartered accountants with over 20,000 members working across the UK and internationally. Our members work across the private and not for profit sectors.
2. ICAS's Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key messages

3. We affirm the need for a preventative approach and challenge of delivering this in a constrained financial environment. There is a need for a focus on longer term solutions that are sustainable and can be supported within available resources. Reform needs to challenge the current models of delivery which are unsustainable from both a financial and resource perspective. The transformative nature and scale of reform is vast and requires clear leadership both at a national and local level to help drive forward the pace of reform.
4. A clear, coherent and holistic strategy is required to set out the vision for a preventative approach and priorities against which we can align resources to focus and support activity as well as measure achievement of long and short term outcomes.
5. A longer term timescale and cross-sector perspective for the strategic planning and investment cycle needs to take a far longer perspective to reflect the long term nature of reform.
6. One of the barriers to radical public sector reform is the underlying discrepancy between the long term gains and delivery of improved public sector outcomes versus shorter term political decisions for electoral advantage. Although there is no easy answer to this, further debate could help to identify ways of narrowing the gap i.e. to align incentives and accountabilities for longer term outcomes and better manage the risks inherent in short-term decisions. Radical reform will require some difficult and unpopular decisions and a political appetite to deal with this.
7. Resources are a key driver and closer alignment with preventative objectives would help to initiate change. This would require transitional arrangements and specific resources.
8. Preventative spending is about investing in the future; initiatives need working capital and while there are a number of barriers to this, we believe that further revenue borrowing powers are needed to facilitate the shift away from crisis spend. Our response also considers alternative finance models, including a co-investment structure to combine local needs assessment and central funding more flexibly as well as a potential streamlining of regulation to support more innovative delivery structures.
9. Critical to the success of this as for any investment decision, is a robust business plan which has clear objectives and decision-making criteria, supported by evidence of a robust 'return on investment'.
10. Support for devolved decision making and public engagement in resource decisions will be necessary to effect the scale of change required.

Our responses to the specific inquiry questions

1. *Why has the progress of reform proposed by the Christie Commission been so slow?*

The scale of reform is vast and there are fundamental issues to manage including culture change. Strong leadership is needed to win the hearts and minds of stakeholders and step up the pace of change. Some shifts may take a generation to crystallise as outcomes. A longer term plan and commitment to implement would better reflect the longer term nature of the reform required.

Expectations of feasible achievements over the short and longer term should be set. A holistic strategy would need clear milestones over a far longer timescale to maintain the momentum.

We have observed that although some progress has been achieved, the example of community planning partnerships appears to be variable, with some more enthusiastically driven than others. A change management programme, driven by leaders who can win the hearts and minds to drive forward progress more significantly is key.

Our view is that there is a fundamental need for a more cohesive approach to identify, put in a position of influence and maximise the potential of leaders at the national, local and organisational level who can help deliver this and drive forward the pace of reform.

2. *What are the main barriers to change and how do we address them in order to accelerate the rate of progress?*

A clear strategic direction

A clear, coherent and holistic strategy is required to set out the vision for preventative spend and priorities to align resources. A longer term timescale and cross-sector perspective for the strategic planning and investment cycle is essential to reflect the long term and inter-generational nature of reform and to provide the framework for decisions based on better long term outcomes.

A clear and holistic strategic planning framework will need to include how the vision will be achieved (including resource requirements), the short and long term milestones as well as an analysis of challenges, risks and how they will be managed to provide some momentum.

Resources

Resources are key to progress the preventative agenda and to make a meaningful change requires a change in direction as to how and where funding is focused. The challenge is that we are facing this demand during a period of resource constraint and the proportion of the budget in health which is targeted on preventative measures is relatively tiny compared to meeting intervention needs, despite evidence that certain conditions such as obesity, diet, alcohol consumption, exercise, smoking and lifestyle increase the incidence of serious health conditions. We note that the Government is providing earmarked funding including integrated care and primary care development funds to aid the transition. Although this is useful, the scale is not sufficient to deliver the step change required.

Although fiscal austerity and changes in budget levels can generate the wrong outcomes, reform needs to challenge the current models of delivery which are considered to be unsustainable from both a financial and resource perspective. The resource requirement and how to identify this funding to deliver meaningful preventative transformation over the longer term needs to be a fundamental part of a holistic strategy.

If we take health as an example, given the current need to focus resources on intervention and acute care, this can only be achieved over the longer term with appropriate transitional arrangements and investment to gradually break out of the current circle.

Funding should follow the priorities and a more joined up approach to tackling the shift would reflect the cross-cutting nature of reform. We understand that community planning areas do not generally currently have shared budgets and there are few pooled budgets (the most significant exception being health and social care integration). This may be one option to encourage a greater degree of cross-sector thinking and drive forwards a holistic approach to reform.

We note that meaningful improvements through community planning are not yet evidenced and would reiterate the need for strong leadership to win hearts and minds and drive forward the pace of reform. The introduction of the Community Empowerment (Scotland) Act 2015 should provide the legislative framework and support to give greater authority and influence to local communities.

Our members in the public sector report that it is difficult to find sufficient time to focus on alternative delivery when the pressures to meet acute needs are so high. Pressures of the day job take precedence as these are what accountabilities are based on and it is where the management and political attention can be focused. This inevitably means the broader long term perspective is locked out – a clear vision for preventative spend would support a shift accompanied by time and space to work through more innovative alternatives.

To assess whether existing spend decisions align with the strategic direction and greater good, a review is needed with a view to focusing resources more effectively on the areas which can evidence transformational change and deliver better outcomes more efficiently.

Alternative finance and managing finances differently

Preventative spend is about investing in the future and initiatives need working capital to facilitate the shift away from crisis spend. While there are a number of barriers to this, we highlight the following:

- Maximising existing tax revenues through economic growth
- Further consideration of innovative tax measures to aid transition
- Alternative models for investment
- Using debt to fund transition and consideration of whether the existing framework for revenue borrowing powers is sufficient to support this shift
- Reducing bureaucracy which may inhibit innovative reform e.g. implications of EU state aid rules and the lack of a level playing field for VAT exemptions.

Delivering economic growth to encourage a vibrant private sector which contributes to the tax base is essential. Economic and political stability is an important ingredient in encouraging and fostering business growth. Business contributes to society more widely than employment and tax revenues and more positive messages supporting the contribution of business to society and providing a fertile business environment also form part of the reform drivers.

The projected increase in demand for services raises a question on whether funding for future public services is sufficient to meet this and support the level of transformational change required. Further consideration of a tax framework which includes an element of evidence based risk management (even on a temporary basis) may aid transition by providing a targeted approach to revenues. An example is alcohol duty or the current debate on a sugar tax.

To offer flexibility in investment decisions and support local decision making, a private sector comparative of government matched funding may provide a framework. Co-investment is a funding approach whereby the Scottish Investment Bank match the funding of a fledgling business by investors (usually business angels). This joint approach is beneficial for Scottish Enterprise as they rely on the due diligence of experts who have invested their own money; it also benefits the business by doubling the available funding to grow. In a public sector context, this could empower local assessment of needs and spending decisions where they have the freedom to allocate some of their own funds. Where a convincing business case is presented this could leverage targeted government 'matched' funding to provide further impetus.

Preventative spend has risks attached to it, however we believe that it is appropriate for the Scottish Government to be able to borrow to fund the revenue aspects of preventative spend initiatives, within an overall prescribed cash limit, where there is a realistic prospect of achieving savings. Our analysis of the existing arrangements (see **Annex 1**) suggests that further revenue borrowing powers would support a shift away from crisis spend.

We also highlight potential regulatory barriers including the effect of EU State Aid rules on grant funding to facilitate preventative spend. We are supportive of a simpler and more targeted approach which exempts smaller organisations so this does not create an unnecessary obstacle to economic growth and delivering services in a more innovative way.

ICAS would also support a more level playing field regarding VAT exemptions across the public sector to reduce the cost and complexity of developing more innovative cross-service delivery options. Further analysis of State Aid rules and the VAT framework is included at **Annex 1**.

Robust business plans

Preparing stronger business cases before investment decisions are made is critical. For every business plan there needs to be a clear case for change, alignment with the strategic priorities, reliable financial data and measurable outcomes - not solely financially quantifiable outcomes. There also needs to be flexibility to assess whether the case supports the greater good and objective of best use of resources.

Decision making process

A greater emphasis on local risk and needs assessment facilitates a preventative based approach. With the introduction of new technologies and drugs, our members report that funding can on occasions be directed to support investment in high cost interventions for a relatively small number of individuals. In addition to the need for a robust business case, it may be appropriate for difficult decisions regarding best supported treatment or new medical interventions to include consideration of the impact on the ability to sustain and support core services for the greater good. Greater community involvement in local decisions could facilitate decision making on the thorny issues of allocation of scarce resources and the need to ensure that this supports the improved health of the overall population.

3. *How do we ensure that the necessary culture change and greater levels of integration takes place?*

Please refer to our comments on leadership.

4. *How do we create a culture of innovation?*

Responses from our members indicate that there is plenty of innovative thinking locally, the challenge is how to scale up these good initiatives. Cultural change is one barrier to this, where professionals and members of the public may have differing views.

We suggest that a central platform would facilitate the sharing and dissemination of inspired initiatives to help scale up successful reforms. Further thinking is needed to identify the most appropriate way to achieve this without creating bureaucracy and institutionalising the process. We also need to share success stories of how to get stakeholders more engaged in new initiatives to help progress cultural change.

5. *What opportunities does digital technology provide in reforming the delivery of public services towards prevention?*

Please refer to our comments on innovation.

6. *How should community planning be developed to support service integration and the focus on prevention?*

Please refer to our comments on leadership.

7. *What lessons can we learn from other countries in delivering a preventative approach?*

We would be interested to see the results of independent research on this topic.

8. *What are the implications for the provision of public services if the decisive shift to prevention does not take place?*

Specifically, in terms of healthcare, our members report that with the increasing demand for services, we will be unable to meet the resource requirements of all projected healthcare needs

using the existing business model. This includes skilled staff as well as costs. Increased demand is driven not only by an ageing population but also technology advances where higher risk and elderly patients are now offered treatments which would not have been available in the past.

We believe that moving away from crisis spending to preventative spending is important. Where preventative spending approaches are successful both individuals and communities benefit and savings can be achieved in the long-term as a consequence of reshaping public services.

Additional commentary on borrowing powers, EU state aid rules and VAT

Borrowing powers

1. In our evidence to the Smith Commission and to the Scottish Parliament's Finance Committee we recommended that the Scottish Government should have additional revenue borrowing powers to fund preventative spending.
2. At present Scottish local authorities can borrow to fund capital within the bounds of the Prudential Code. The Scotland Act 2012 gives limited borrowing powers over capital and revenue which will be extended further following the implementation of the Smith Commission Agreement. Neither the Smith Commission report nor HM Government's 'Scotland in the United Kingdom: An enduring settlement' refer to preventative spending in their respective commentaries on borrowing powers. Therefore, in our view, the reports could not be interpreted as permitting revenue borrowing to fund the revenue aspects of preventative spend.
3. Borrowing for capital projects has always been viewed as preferable to borrowing to fund revenue expenditure on public services due to the benefits accrued from capital expenditure being spread over more than one financial year. A key overarching objective of preventative spending initiatives is to reduce demand for public services and create future savings. Preventative spending, like capital spending, is about investing in the future. In our view, this provides clear justification for the extension of the Scottish Government's revenue borrowing powers to fund preventative spend initiatives within prescribed limits.
4. Charities are major providers of public services and we believe that there is knowledge and experience within this sector which is vital to the success of preventative spending approaches. While there are a number of barriers to taking forward preventative spend initiatives, some of which could be overcome within the existing devolved arrangements, we believe that further revenue borrowing powers need to be devolved to support a shift away from crisis spend.
5. The debt financing of charities by government is a potential model for providing working capital to charities for preventative spend initiatives. However, debt financing, where interest is charged below commercial rates, has the potential to be caught by the EU State Aid rules. The State Aid rules were created to promote competition and control state subsidy levels so as to maintain a level playing field across Europe. In practice, this means that government funding such as grants to a small enterprise, the creation of targeted tax reliefs to stimulate economic growth or investing in a framework to facilitate a move towards more preventative spending could be classed as 'State Aid' if certain criteria and tests are met.
6. Although preventative spend has risks attached to it, we believe that it is appropriate for the Scottish Government to be able to borrow to fund the revenue aspects of preventative spend initiatives, within an overall prescribed cash limit, where there is a realistic prospect of achieving savings. The resultant savings could reduce public spending in the long-term or free up resources which could be re-deployed elsewhere in the public services.
7. In addition to placing an overall cash limit on the amount the Scottish Government can borrow for preventative spending initiatives, we would envisage that borrowings would need to be repaid within a specified period of time and that governance arrangements would include measures to ensure that borrowings could not be used to fund recurrent revenue expenditure.
8. Borrowing must be affordable, sustainable and prudent and should be shared proportionately with future generations. Therefore, borrowing powers, in the context of the fiscal framework must be structured with these principles in mind whether these are exercised to fund shortfalls in taxation revenue, investment in assets or for preventative spending.

EU State Aid rules

9. Our understanding is that State Aid rules were created to promote competition and control state subsidy levels so as to maintain a level playing field across Europe. In practice, this means that

government funding such as grants to facilitate a move towards more preventative spend would need to be assessed to identify if it would be classed as 'state aid'.

10. We would support raising the State Aid threshold to exempt smaller organisations. This would also help to reduce red tape and focus more on economic growth and delivering services rather than competition which we view as a lower priority.

VAT framework

11. The differing VAT status of parts of the public sector under the UK rules gives a VAT recovery shelter to some organisations but not other organisations delivering the same services to the same end users. ICAS has written to HMRC raising a concern that this lack of a level playing field inhibits more innovative service delivery options. Moving activities traditionally delivered by an organisation within a VAT shelter to a new organisation unable to benefit from VAT recovery will increase the costs of providing that service by 20% before any other changes are contemplated. There are also additional resources required to provide specialist advice and develop structures which fit with the VAT rules. We argue that this is not in the wider public interest.