

**DMT Report – November 2014**

**Jennifer McKie, Senior Music Adviser**

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# Lincolnshire Music Service – Life beyond the Local Authority...

## BACKGROUND

Lincolnshire Music Service (LMS) presented to DMT in June 2014 a paper, outlined in appendix 1, detailing the potential of externalisation. Approval was given to:

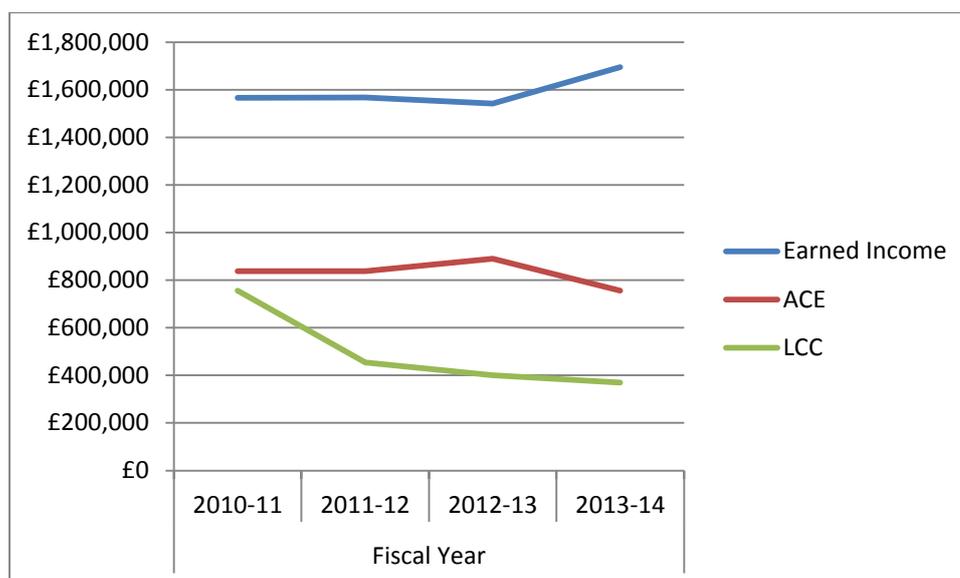
1. Engage an external finance company to provide a report, in partnership with LCC Finance, to ascertain the viability of LMS as an external entity
2. Research further the legal forms available and bring back to DMT in autumn 2014

In addition it was recommended by Sally Savage / Andrew Mclean that contact was made with the Enterprise Growth Manager who would be able to assist in terms of business and long-term planning.

## FUNDING

LMS is a traded service with the following grant and income streams:

- Arts Council England (ACE) – DfE Music Grant 2012-2015 (grant extension 2015-16)
- Lincolnshire County Council (LCC)
- Traded Stakeholder Income



Fiscal Year	2010-11	%	2011-12	%	2012-13	%	2013-14	%
ACE	837,730	27	837,730	29	890,121	31	755,793	27
LCC	755,340	24	453,870	16	401,102	14	370,210	13
Earned Income	1,565,579	49	1,567,853	55	1,541,358	55	1,694,748	60
Total	3,158,649		2,859,453		2,832,581		2,820,751	

## FINANCIAL ANALYSIS (CERT AND LCC)

### OVERVIEW

The external finance company, CERT (as outlined in appendix 2), were recommended by Bates, Wells & Braithwaite who offered legal advice to LMS regarding the potential options for externalisation and transfer prior to the initial presentation to DMT in June 2014. They are a specialist business experienced in supporting social enterprises, mutual, charities and co-operatives.

The full financial synopsis and report, as outlined in appendix 3 and 4, reviews the financial work already undertaken by LCC and explores the hidden shared services costs being provided to the service by LCC. The reports also investigate some of the benefits that may be available to an externalised service if LMS became a registered charity. The reports have been drawn up in order to consider the current and future operating cost of the service, explore factors that directly impact on the viability of the business case and identify strategies for the service moving forward.

LMS requires £2.7m in operating costs and is currently subsidised by LCC. The funding gap in 2014/15 is budgeted at £0.3m. Through price increases and cost reduction exercises LMS will have reduced the LCC contribution by one third to £0.2m in 2015/16.

## Lincolnshire Music Service

Headline Figures	*2013-14		^2014-15		^2015-16
<b>Income</b>	£		£		£
<b>Total</b>	<b>2,480,599</b>		<b>2,386,341</b>		<b>2,542,885</b>
<b>Direct Costs</b>					
<b>Total Direct Costs</b>	<b>2,134,501</b>	86%	<b>2,122,193</b>	89%	<b>2,148,848</b> 85%
<b>Gross Surplus</b>	<b>371,478</b>	15%	<b>264,148</b>	11%	<b>394,037</b> 15%
<b>Overheads</b>					
<b>Total Overheads</b>	<b>534,765</b>	22%	<b>619,173</b>	26%	<b>594,034</b> 23%
<b>Net Surplus (Deficit)</b>	<b>(163,287)</b>	-7%	<b>(355,025)</b>	-15%	<b>(199,997)</b> -8%
<b>LCC Contribution</b>	<b>163,287</b>		<b>355,025</b>		<b>199,997</b>
* - Actual from SAP; ^ - Budget from SAP; % of income;					

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The future analysis is based on the service opting for a charitable organisational structure. It should be noted that there are identified opportunities within this report that will only be available to an external charitable entity.

### Business Case Summary

<b>Externalised Entity: Charity</b>	<b>2016-17</b>		<b>2017-18</b>		<b>2018-19</b>	
Income	£		£			
<b>Total</b>	<b>2,525,965</b>		<b>2,561,083</b>		<b>2,596,903</b>	
<b>Direct Costs</b>						
<b>Total Direct Costs</b>	<b>2,088,742</b>	82.7%	<b>2,094,367</b>	81.8%	<b>2,119,070</b>	82.1%
<b>Gross Surplus</b>	<b>437,223</b>	17.3%	<b>466,716</b>	18.2%	<b>464,864</b>	17.9%
<b>Overheads</b>						
<b>Total Overheads</b>	<b>444,724</b>	17.6%	<b>459,545</b>	17.9%	<b>460,675</b>	18.2%
<b>Net Surplus (Deficit)</b>	<b>(7,501)</b>	-0.3%	<b>7,171</b>	0.3%	<b>4,189</b>	0.2%

### **FINANCIAL CONCLUSION**

The reports demonstrate that there are factors in favour of externalisation in that LMS is clearly capable of managing its budgets prudently. LMS has demonstrated a track record in reducing its required contribution year on year from LCC whilst effectively maintaining a substantial service to children and young people within Lincolnshire.

LMS, as an externalised entity, would only need to identify a combined annual income target and efficiency saving representing 8% of income of the 2015-16 budget. In taking a combined strategy it is possible to achieve a break even and possibly a modest surplus in future years.

LMS derives the majority of its income from fees which demonstrate customer buy-in and local demand. Opportunities are actively explored and there is a keen understanding of the Music Service and its potential.

The externalised entity will face additional costs from the 'in-kind' shared services provided by LCC however these costs should not have a material impact on the overheads of the service.

Cash flow is a key risk factor that requires mitigation and a combination of process changes to invoicing and financial support will be required. This is not insurmountable though and through transfer planning and due diligence this should be resolved.

Another key risk for LMS whether aligned to LCC or externalised is the continuation of ongoing DfE music funding. The funding is secure 2012-2015 with a confirmed grant extension 2015-16. There will also be a likely uplift in funding of 19% which is yet to be confirmed by Arts Council England. This funding represents around one third of the service's income and the withdrawal of significant reduction would have material impact on LMS. This is unlikely however and an externalised entity would have increased ability to draw on funding and other income opportunities easier as a charity.

### LEGAL FORM

The report presented in June 2014 to DMT outlined the potential business models weighing up both the advantages and disadvantages of each in detail. It included:

- Community Interest Company (CIC)
- Charitable Company limited by Guarantee
- Charitable Bencom
- Co-operative
- LA Traded Service

The option for LMS to be subsumed by a 3<sup>rd</sup> Party could not be considered as the level of return expected would be unviable and jeopardise future funding arrangements with key funders e.g. Arts Council England.

Post-presentation in June 2014, further discussion took place with Tony Warnock and Mark Popplewell regarding an additional option which could be LMS as an Arms' Length organisation. It is unclear what the advantages of this would be other than the absorption of current in-kind services at zero cost. These have been identified within the external report and shouldn't be a key issue for LMS. If this was a model that LCC wish to explore a checklist of questions/issues would need drawing together to establish the nature of the arms' length agreements to be proposed.

The final option which was proposed by Bates, Wells & Braithwaite at the beginning of July 2014 is a Charitable Incorporated Organisation (CIO), as outlined in appendix 5. CIOs were launched in January 2013 and are the only bespoke incorporated legal form for charities. It has the flexibility for a model which incorporates elements of a staff mutual within it.

### **PREFERRED LEGAL FORM AND BUSINESS MODEL**

The preferred legal form, as recommended by Bates, Wells and Braithwaites, would be a hybrid model of a Charitable Incorporated Organisation (CIO) and a Staff Mutual.

A CIO is the only bespoke incorporated legal form for charities and there are now more than 1300 CIOs registered with the Charity Commission and the number is rising. For CIOs, there is just a single regulator – the Charity Commission- and CIOs only have to comply with the Charities Acts and CIO regulations. Charities are the only legal structure that benefits from wide tax reliefs such as gift aid and potential donations. Being a CIO means that the charity will have legal personality and can enter into legal relationships in its own name. In most situations, it is the CIO, rather than the members or trustees, which would be responsible for the charity's debts or for any other liabilities that might arise from its legal relationships. The advantages and disadvantages of the CIO are outlined in appendix 6.

In September 2014, LMS carried out some informal consultation, overview in appendix 7, with LMS staff members focusing on the prospect of externalising the organisation. They are our greatest asset and they demonstrated a real ambition to externalise LMS which a shared desire for ownership of the new organisation. This was an exciting development and a critical component within the preferred legal form governance in terms of influence.

### **Economic Growth (NBV)**

It was recommended by Sally Savage / Andrew Mclean that contact should be made with the LCC Enterprise Growth Manager, Sally Harrison, who would be able to assist in terms of business and long-term planning.

LMS has secured business planning support from NBV Enterprise Solutions Limited as part of their Business Start Up Support programme which is a funded service offered to businesses in Lincolnshire. NBV is a social enterprise funded largely by Regional Growth Fund and European Regional Development Funds as well as some commercial activities. They specialise in the production of Business Plans for new start-ups and growing businesses.

A new style LMS business plan, outlined in appendix 8 in draft format, has now been put together with an attractive simple and focused approach in a readable format for a range of stakeholders and key commercial funders.

## **What Next – key questions?**

### What processes are in place to secure approval for externalisation?

I assume approval will be needed by members and when is the earliest opportunity for presentation and debate to take place?

### When should the transfer take place?

There are two main opportunities to externalise which are:

- 1<sup>st</sup> September 2015
- 1<sup>st</sup> April 2016

In order to secure and maintain the business it would be sensible to opt for 1<sup>st</sup> September as an implementation date. This also allows LMS to externalise and secure additional charitable funding post 2016. In discussion with ACE, the funding agreement 2012-2016 would remain with DfE with LMS as the lead organisation of the Lincolnshire Music and Arts Education Hub regardless of whether LMS is a LA service or not. The risk rating will escalate though up until the point of transfer.

### Consultation?

LCC HR has confirmed that a consultation period of 45 days would be necessary and there would be two parallel elements of the process:

- LMS Management Review and Restructure
- Externalisation

A meeting with LCC HR has been arranged post the DMT presentation in November 2014.

### Pre-requisites and measures?

In order to achieve independence for LMS and remove the longer-term liability for LCC there need to negotiated pre-requisites such as:

In order to achieve independence for LMS and remove the longer-term liability for LCC there need to be a number of pre-requisites in place:

- The agreement to carry forward any LMS surplus into the new organisation post April 2015
- Underwrite the redundancy costs accrued up until the time of TUPE transfer, in perpetuity
- Agree to finance the bond (circa £190k) for the Trust to become a recognised body for TPS. This bond is a hypothetical representation of funds as a guarantor which could sit within the reserves of LCC.

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- Transfer of existing assets e.g. instruments which are of no material value to LCC. If this was agreed in principle a full inventory would be confirmed.
- Benevolent loan agreement if needed during the first 12 months to address cash-flow vulnerability
- The agreement for LCC to continue to administer the Assisted Instrument Purchase Scheme enabling tax free purchasing for families within the county. This is a relatively straight forward tax free purchase process for parents with no financial burden to LCC. Suppliers have already been identified through the central purchasing team and therefore the administration would be minimal.
- The agreement for LCC to pass to LMS, any funds that are collected through Standing Orders that were set-up in favour of LMS, by parents, prior to the transfer (e.g. membership fees for county ensembles and foreign tours). (This arrangement would effectively apply only for a few months after the date of transfer.)
- A data sharing agreement between LMS and LCC in order to validate information e.g. FSM/LAC CYP impacting subsidised tuition. This is also necessary to complete the annual data return requested by ACE.

The TUPE measures that would need considering would be relating to technical, economic and organisational and would include:

- Childcare vouchers
- Mileage rates

Independent legal advice would be secured through Bates Wells & Braithwaite, who are not only knowledgeable within the field but have also assisted Northamptonshire Music and Performing Arts Trust and other services to achieve independence recently. The initial quoted costs for the externalisation are outlined in appendix 9.

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Appendix 1: DMT Report June 2014 – Life beyond the Local Authority...

## **Lincolnshire Music Service – Life beyond the Local Authority...**

**DMT Report – October 2014**

**Jennifer McKie, Senior Music Adviser**

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### **Lincolnshire Music Service – Life beyond the Local Authority...**

#### **Background**

Lincolnshire Music Service (LMS) is a successful traded service with an excellent reputation. An external review carried out by Richard Hallam MBE, the DfE consultant on the National Plan for Music Education concluded:

"LMS is an outstanding music service. LMS provides outstanding music leadership, achieves excellent standards and delivers high quality activities through a diverse range of opportunities for all"

LMS is the lead organisation of the Lincolnshire Music and Arts Education Hub (LMAEH) which consists of 20 organisations united in providing the best possible music opportunities for all children regardless of their circumstances or background. During 2013/4 around 18,000 children and young people accessed music opportunities via LMS resulting in over 90% of schools receiving provision.

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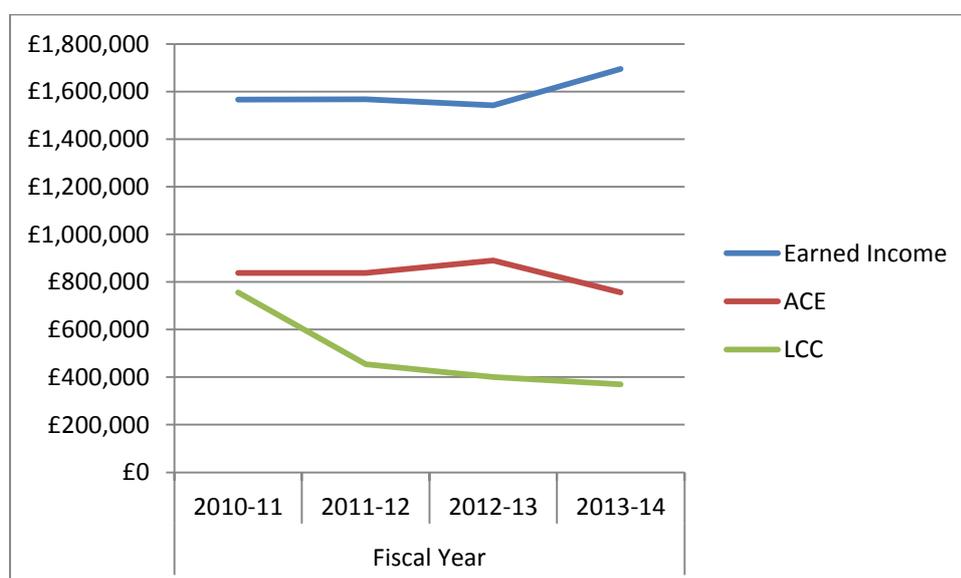
## Funding

LMS is a traded service with the following grant and income streams:

- Arts Council England (ACE) Music Grant (DfE funding)
- Lincolnshire County Council (LCC)
- Trading Stakeholder Income

Since 2010, LMS has received a 30% reduction in central funding through ACE and LCC.

Grant Funding including overall % level of contribution and earned income: (INSERT NEW GRAPH)



Fiscal Year	2010-11	%	2011-12	%	2012-13	%	2013-14	%
ACE	837,730	27	837,730	29	890,121	31	755,793	27
LCC	755,340	24	453,870	16	401,102	14	370,210	13
Earned Income	1,565,579	49	1,567,853	55	1,541,358	55	1,694,748	60
Total	3,158,649		2,859,453		2,832,581		2,820,751	

The ACE grant conditions are explicit with an agreed LMAEH business plan. The core requirements of the funding state children from all backgrounds and every part of England should have the opportunity to learn a musical instrument including whole class ensemble teaching programmes; to make music with others; to learn to sing; and to have the opportunity to progress to the next level of excellence if they wish to.

The ACE funding formula is based on a 'per pupil' formula, along with a weighting for pupils in receipt of Free School Meals. In rural areas, the costs associated with providing services to and reaching all schools (especially on the peripherals of the county) is expensive. We receive no additional funding for travel time or travel costs.

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It has been confirmed that the ACE grant will be extended into 2015/16 providing stability for a further year. This confirmation includes an additional £18 million contribution from the DfE during 2015/16 with specific allocations directed to music hubs across England. These are yet to be confirmed.

LCC funding does not have a set of grant conditions attached and therefore the budget is currently used to offset the totality of the budget at the end of the financial year.

Despite reduced funding overall, LMS has remained robust and adapted resulting in:

- Efficiencies through smarter timetabling, travel arrangements and online claiming and other online processes
- Savings through streamlined delivery through LMAEH, training and other everyday costs e.g. instrument purchasing
- New contractual arrangements moving away from Teachers T&Cs to an annualised hours contract set at 75% with claimable additional hours
- Full restructure reducing the number of full-time staff including management

Throughout this time, LMS has developed a range of high quality products available to stakeholders set at realistic charges and delivered by an experienced team. These products are aligned to the core and extension requirements of the National Plan for Music Education.

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### Financial Analysis

LMS is aware of the rapidly changing landscape and we must assume the withdrawal of the 2015/2016 LCC contribution. Regardless of the business model adopted post 2015, the financial position must be robust and balanced.

Detailed analysis, as outlined in appendix 4, has been carried out in partnership with LCC finance which includes identifying trading trends and the level of subsidy required to maintain a viable service. A range of factors have been included:

- Management
- Overheads including mileage / travel time etc.
- Administration
- Other partnership work (other hired services)

All calculations are based on actual trading hours which have been analysed to identify trends and the impact of varying levels of buy-back. The level of subsidy is projected to decrease with the complete withdrawal of LCC reliance by 2015-16.

#### Financial position - 2013/2014

Funding	Total
ACE	£755,793
LCC	£370,210

Product	Hours per annum	Total costs per hour	Total Subsidy per annum
Individual, small group and whole class tuition	47,162	£41.97	£476,855
Total			£476,855

The overall level of subsidy contribution required was £558,927 which also included:

- Music centre activity
- County ensembles
- Other projects e.g. live music
- Other hired services
- Free school meal and looked after children remission

There was a surplus of £193,000 due, in part, to the number of charging weeks (37) available during this financial year (LMS schedules 36 teaching weeks in the academic year). A case was presented for the carry forward of these funds into 2014-15 but rejected due to financial regulations.

## Lincolnshire Music Service – Life beyond the Local Authority...

### Financial position - 2014/2015

Funding	Total
ACE	£755,793
LCC	£402,696

Product	Hours per annum	Total costs per hour	Total Subsidy per annum
Individual, small group and whole class tuition	41,753	£43.12	£380,509
Total			£380,509

The overall level of subsidy contribution required is £465,704 which also includes:

- Music centre activity
- County group ensembles
- Other projects e.g. live music
- Other hired services
- Free school meal and looked after children remission

An increase in charges (academic year related) to stakeholders from September 2014 was agreed following a DMT presentation in March 2014 and a 10% decrease in buy-back predicted as a direct impact of increased charges. This was essential to prepare for the withdrawal of LCC funding and the instability of the DfE funding post April 2015.

Although 2014-15 represents 35 charging weeks compared with 37 weeks in 2013-14, LMS projects around £280k surplus at the end of the financial year. There are other factors which have been considered to arrive at this figure which are estimated at this stage:

- Independent legal advice<sup>i</sup> to support transfer arrangements
- The impact on income due to adverse weather conditions or other external factors
- Potential LMS tutor pay increase (1%) and other incremental pay awards
- Initial set-up costs including IT, HR, payroll and premises calculated at around £40k however LCC still to confirm 'in-house' central costs i.e. contributing costs to fulfil the council's functionality. Mark Popplewell has agreed to quantify for LMS.

Calculations, as outlined in appendix 5, also confirm the impact on the overall level of subsidy according to a varying level of buy-back from schools and the financial impact. This has been set at 100%, 90% and 80% buy-back compared with 2013-14. The calculations highlight that the decreased level of buy-back does not make a significant impact on the overall budget.

The proposal would be to agree the carry-forward of surplus funds into 2015-16 to pump-prime the new business model post April 2015.

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### Financial position - 2015/2016

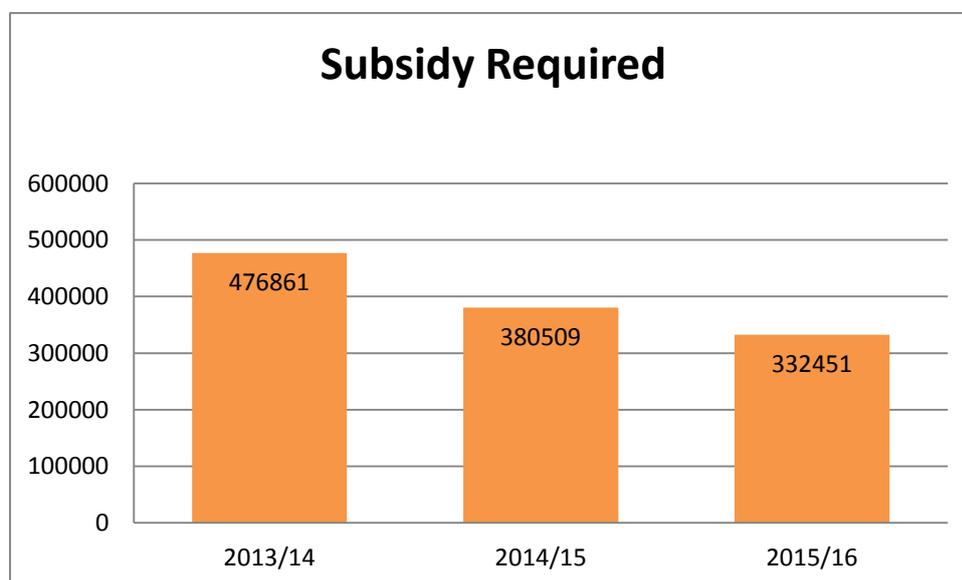
Funding	Total
ACE	£755,793
LCC	£0

ACE funding 2015-16 has been confirmed extending the funding period by one year. An assumption has been made that the level of funding will remain stable however this will be confirmed by July 2014.

Product	Hours per annum	Total costs per hour	Total Subsidy per annum
Individual, small group and whole class tuition	41,363	£43.22	£332,446
<b>Total</b>			<b>£332,446</b>

The overall level of subsidy contribution required is £417,901 which also includes:

- Music centre activity
- County group ensembles
- Other projects e.g. live music
- Other hired services
- Free school meal and looked after children remission



*This chart shows a diminishing requirement for subsidy over 3 fiscal years.*

Additional costs to consider during 2015/16 will depend on the model secured moving forward but will include:

- IT Support
- HR and Payroll

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- Possible premises hire

Further research has taken place to project additional overhead costs as an independent organisation and is detailed below:

Area	LA costs per annum	External costs per annum	Impact on buy-back per hour
IT	Awaiting costs	£8,000	19p
HR	Awaiting costs	£8,000	19p
Payroll	Awaiting costs	£4,500	10p
Premises hire	n/a	£10,000	24p
Total		£30,500	72p per hour

Although the table outlines the impact as an hourly cost to stakeholders, it is envisaged that these costs would be secured through efficiencies.

### Challenges

LCC has continued to support LMS over many years and it is because of this support the service has grown in size as well as reputation. The high level of financial support has been exceptional and compares well with other authorities across the East Midlands and beyond. It is inevitable, however, that LCC will withdraw funding post April 2015 and there is a need to:

- Minimise the level of political impact
- Choose the most appropriate legal form for LMS
- Continue to provide a range of music opportunities for children and young people within the county.

Operating as a traded service within an LA commissioning infrastructure represents a number of key challenges:

- Lack of restrictive covenant within LCC contract therefore less ability to protect existing business
- The inability to carry forward surplus funding e.g. 2013-14 surplus of £193k therefore reduced opportunity to reinvest and increase provision for children and young people
- The lack of control over decisions directly impacting LMS budgets e.g. mileage rate increase, pay and reward consultation, mandatory LCC training.
- The lack of clarity relating to the LCC contribution (14% of total) resulting in risk and control to the totality of the budget e.g. Proposed withdrawal of FSM funding set at £95k contravening the key requirements of the ACE grant.
- The implementation of LCC recruitment procedures for all posts regardless of direct business in need of delivery or critical business roles within the service e.g. LMS finance officer contract expired and no replacement or interim arrangements.
- The current infrastructure makes cross-border collaboration difficult due to the current funding position e.g. Peterborough and North East Lincolnshire Music Service Contracts
- The inability to claim gift-aid or other charitable funding streams which could directly impact children and young people within the county
- Governance – ultimately LMS employees can advise but decisions taken centrally regarding critical decisions and future direction e.g. structure and policy.

LMS understands LCC's role as a commissioning service and the challenges / liabilities surrounding a traded service. LMS has demonstrated over many years the viability of the business however doesn't have control of many critical decisions that impact its sustainability.

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### The Legal Form

LMS proposes to work in partnership with LCC to get to the point of achieving a viable entity post April 2015.

The partnership would remove the liability for LCC without the removal of the service which would be politically volatile within the county. This would also enable the council to achieve its objective of a commissioning council post April 2015 if appropriate.

The following questions have been addressed<sup>ii</sup> in order to clarify the most appropriate legal form for LMS:

Area	Questions
Funding and finance	What are our income streams? How will we diversify income? Will we be applying for grants/other public funding? Will members of the public donate/buy services?
Tax considerations	Do we want access to charitable tax breaks (e.g. no corporation tax on profits, gift aid, business rates relief etc.)?
Social purpose embedded into legal structure	Is it important that the social purpose of the service is part of the legal structure (e.g. stated in the constitution)?
Flexibility	How much flexibility do we want about the direction of the service? Could we deliver other commercial activities?
Reputation and kudos	What impression does the new entity need to give to members of the public? Is it important that the new entity seems charitable?
View/role of Local Authority	What role will the LA have in respect of the new entity? What will the funding/contractual relationship be with the LA?
Governance	Who do we want to be on the Board? Do we want employees on the board/to take membership? What about the service users? How will we ensure the board has appropriate skills? Is it important that employees/ the public are seen to "own" or "control" the entity?
Administration	How do we feel about external regulation and scrutiny / filing document and reports?
Timescale	How urgent is the establishment of the new entity?

# Lincolnshire Music Service – Life beyond the Local Authority...

## Research

In depth research has taken place since the concept was pitched to the CfBT Senior Leadership Team in December 2013. This has included:

- Preliminary discussions with LMS Senior Managers
- Financial review in partnership with LCC finance
- Meetings with a range of services operating in varying models including Northamptonshire (Independent Trust), Birmingham (Independent Trust in partnership with other traded services) and Staffordshire (Bought and operated by a 3<sup>rd</sup> Party, alongside other traded services)
- Meetings with neighbouring music services to ascertain other business potential e.g. North East Lincolnshire Music Service regarding future alignment of provision
- Legal advice, Bates Wells Braithwaite, Erica Crump, Senior Associate

## Potential Business Models Considered

The table below outlines the potential benefits and any limitations for each legal form considered which include:

- Community interest company (CIC)
- Charitable company limited by guarantee (Trust)
- Charitable bencom (IPS community benefit society)
- Co-operative (Industrial and Provident Society)
- LA traded service

Please note that the option for LMS to be subsumed by a 3<sup>rd</sup> party organisation could not be considered. The level of return expected would be in the region of 12-14% and this would be unviable for the service as well as jeopardise funding arrangements with our key funders e.g. Arts Council England. A high profit margin would increase prices to a point that the market would not sustain the service.

Legal Form	Pros	Cons
Community Interest Company (CIC)	<p>A CIC is a type of company with a community purpose and a lock over its assets</p> <p>Employees can be directors – this means the head of service and other employees can sit on the board. Non-employee directors can also be paid for their services</p> <p>Social enterprise "brand" – the CIC is widely seen as a type of social enterprise (a company with a social purpose)</p>	<p>No tax reliefs unlike charities</p> <p>CICs are less well known than charities</p> <p>Less public trust than a charity</p> <p>Some funders may be less likely to fund a CIC than a charity</p>

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	<p>The CIC Regulator/Companies House are regulators of CICs. They are both light touch regulators</p> <p>CICs can offer shares to members of the public/organisations if CIC limited by shares i.e. may be able to raise equity finance</p> <p>Easy and quick to set up</p> <p>Easier to carry out more commercial activities than a charitable legal structure</p> <p>Potential to achieve recognised body status for Teachers Pension Scheme</p>	
<p><b>Conclusion:</b>          This option would be relatively straight forward to set up with a community purpose and lock over the assets. As employees can be Directors, this would allow the Senior Music Adviser and other employees to sit on the Board. There would however be some infrastructure set-up needed and a major disadvantage would be no tax reliefs unlike charities. Some funders may also be less likely to fund a CIC than a charity with less public trust</p>		
<p>Charitable Bencom (IPS Community Benefit Society)</p>	<p>Should be able to register with HMRC for charitable tax reliefs</p> <p>Not regulated by the Charity Commission, so easier to get employees (like the Head of Service) on the Board of Directors than a charity registered with the Charity Commission</p> <p>The Financial Conduct Authority (FCA) is more "light-touch" as a regulator than the Charity Commission</p> <p>Widely seen as a democratic model (1 member, 1 vote). The Bencom will have a wide membership who will collectively control the service</p>	<p>A Bencom must have a wide membership. For music service this membership groups is likely to be students/parents/staff who are likely to have rights to vote in the directors/remove directors/attend annual general meetings. This shifts control to a wide membership group</p> <p>Stakeholders, funders, and the public are less likely to understand what a Bencom is (as it has no registered charity number and is far less common legal form than a registered charitable company)</p> <p>It is anticipated that in the future Bencoms will be regulated by the Charity Commission at which point the Commission could</p>

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		<p>require employees to be removed from the board of directors</p> <p>HMRC may have questions about employees sitting on the board of directors before granting charity tax reliefs</p> <p>FCA is a less efficient regulator than the Charity Commission/Companies House</p>
<p><b>Conclusion:</b> Although widely seen as a democratic model, it would result in a wide membership who would collectively control the service. For LMS this membership group is likely to be a range of stakeholders which shifts the control to a wider membership. This could be potentially too risky to meet the objectives of our key funders.</p>		
<p>Co-operative (IPS)</p>	<p>Seen as a democratic model (1 member, 1 vote)</p> <p>The Co-op would have a wide membership who would collectively control the service</p> <p>Members of the co-op can be paid shares</p> <p>Buy-in and support from the membership</p> <p>Part of the co-operative movement</p> <p>Could achieve recognised body status for Teachers Pension Scheme (TPS)</p>	<p>The Financial Conduct Authority (regulator of Co-ops) less efficient than Companies House/Charity Commission</p> <p>The Council/public may not want members to be able to receive dividend out of the Co-op as this takes money away from the services and into the pockets of members</p> <p>Does not give out a message to the public/council/members that it is not for profit as profit can be distributed to members</p> <p>A co-op must have a wide membership which is likely to be students/parents/staff etc. who are likely to have rights to vote in the directors/remove directors/attend annual general meetings. This shifts control to a wide membership group.</p>
<p><b>Conclusion:</b> Although widely seen as a democratic model, it would result in a wide membership who would collectively control the service. For LMS this membership groups is likely to be a range of stakeholders which shifts the control to a wider membership. This could be potentially too risky to meet the objectives of our key funders.</p>		

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<p>LA Traded Service</p>	<p>Kudos and profile already in place and therefore an element of stability from stakeholders</p> <p>Established infrastructure however costs are still to be confirmed</p> <p>Support provided by LA and Cllrs.</p>	<p>No tax reliefs (unlike charities)</p> <p>Some funders may be less likely to fund a LA than a charity</p> <p>Financial restrictions limited ability to trade e.g. carry forward potential</p> <p>Tensions between funding agreements of key funders e.g. ACE and LCC</p> <p>Lack of control and flexibility would remain, limited trading potential e.g. external contracts</p> <p>Inability to extend online trading options e.g. paypal</p> <p>Lack of restrictive covenants within a commissioning authority</p>
<p><b>Conclusion:</b>                  The removal of LCC funding would reduce the benefit of aligning provision with the LA. The ability to carry forward funds would be beneficial for the service impacting children and young people directly. It would provide an element of stability regarding the infrastructure issues of HR, finance and payroll however central costs are still to be confirmed. The tensions surrounding control and flexibility would still remain, limiting the trading potential of the service.</p>		

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### Preferred Legal Form and Business Model

Legal Form	Pros	Cons
Charitable company limited by guarantee (Trust)	<p>The public trusts registered charities and are reassured by a registered charity number</p> <p>Charities are the only legal structure that benefit from very wide tax reliefs (e.g. gift aid, no corporation tax on charitable trading profits, business rates relief, no stamp duty land tax, inheritance tax relief etc.)</p> <p>Maximum access to trust, foundation and public funding as a registered charity, although many funders will fund other not for profit legal structures</p> <p>LAs may only want to transfer the service to a registered charity (for reputational and governance reasons)</p> <p>Could achieve TPS recognised body status</p>	<p>Difficult for employees to be directors (known as trustees) of the charity. This means the Head of Service and other staff can only sit on the board with special consent from the Charity Commission</p> <p>It is necessary to have at least 2 or 3 entirely independent directors</p> <p>The Charity Commission has extensive regulatory powers/powers to intervene/launch investigations</p> <p>Charities have the least flexibility over their activities/commercial trading although it is possible to set up a trading arm</p> <p>Cannot pay dividends/raise equity finance</p>
<p>Conclusion: In partnership with the LA as a commissioning authority, LMS would agree a set of pre-requisites with the LA to achieve independence. It is likely the Trust would be an admitted body for TPS and have the flexibility to make its own decisions according to business need. Charitable status would also benefit LMS through a range of tax reliefs. There is already a precedent within the East Midlands for this as an option which was a highly successful collaboration between LA and Northamptonshire Music Service.</p>		

Lincolnshire Music Service is:

- large, with a turnover of around £3 million
- automatically high risk due to its 100 employees
- reliant on trading, so vulnerable to market forces
- Although financially viable it is dependent on some continued level of public funding so vulnerable to decision outside of its immediate control.

The preferred structure for LMS is a free-standing Independent Trust with charitable status. Charities are the only legal structures that benefit from wide tax reliefs such as gift aid and

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potential donations. Although the Trust wouldn't be a legal entity in itself, it would be a convenient overarching body supporting the trading company (company limited by guarantee, not shares) that works alongside the registered charity.

The Trustees/Directors will be unobtainable unless there is some level of protection through limited liability.

Although it can be difficult for employees to be trustees/directors of the charity, special consent can be given from the Charity Commission. This consent isn't unusual and a precedent has already been set with other music services within the region and beyond.

The ability to function as an independent organisation would also provide the opportunity for LCC to commission aspects of the work, if felt appropriate, within a tighter and much more focused budget framework e.g. Lincolnshire Youth county group performances such as the Youth Orchestra in Lincoln Cathedral.

The greatest asset of LMS is its people however we understand that they also bring with them the greatest financial liability.

In order to achieve independence for LMS and remove the longer-term liability for LCC there need to be a number of pre-requisites in place:

- The agreement to carry forward any LMS surplus into the new organisation post April 2015
- Underwrite the redundancy costs accrued up until the time of TUPE transfer, in perpetuity
- Agree to finance the bond (circa £190k) for the Trust to become a recognised body for TPS. This bond is a hypothetical representation of funds as a guarantor which could sit within the reserves of LCC.
- Transfer of existing assets e.g. instruments which are of no material value to LCC. If this was agreed in principle a full inventory would be confirmed.
- Benevolent loan agreement if needed during the first 12 months to address cash-flow vulnerability
- The agreement for LCC to continue to administer the Assisted Instrument Purchase Scheme enabling tax free purchasing for families within the county. This is a relatively straight forward tax free purchase process for parents with no financial burden to LCC. Suppliers have already been identified through the central purchasing team and therefore the administration would be minimal.
- The agreement for LCC to pass to LMS, any funds that are collected through Standing Orders that were set-up in favour of LMS, by parents, prior to the transfer (e.g. membership fees for county ensembles and foreign tours). (This arrangement would effectively apply only for a few months after the date of transfer.)
- A data sharing agreement between LMS and LCC in order to validate information e.g. FSM/LAC CYP impacting subsidised tuition. This is also necessary to complete the annual data return requested by ACE.

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The TUPE measures that would need considering would be relating to technical, economic and organisational and would include:

- Childcare vouchers
- Mileage rates
- Post transfer financial review
- Post transfer management team review

Independent legal advice would be secured through Bates Wells and Braithwaite, who are not only knowledgeable within the field but have also assisted Northamptonshire Music and Performing Arts Trust and other services to achieve independence recently.

### Timeline

It is envisaged that although the Trust could be established, with the consent of LCC, within around 3-6 months, it would be necessary to launch the Trust at the start of the new financial year (April 2015). Bates Wells and Braithwaite have recommended allowing at least 3 months for the final stage of the transfer.

It would be sensible to align with LCC and therefore commence activity relating to the transfer as part of the next round of change post the senior management review i.e. September 2014. This would allow all LMS staff members to be made aware of the proposed change in September with enough time for negotiation before the implementation date of April 2015. It is vital that LMS staff members are aware of any proposed changes at the earliest stage and therefore necessary to treat any negotiations as confidential until September 2014.

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<sup>i</sup> Bates Wells and Braithwaite (Erica Crump, Senior Associate) are the preferred legal organisation to administer the move away from the LA and come highly recommended from other music services e.g. Northamptonshire.

<sup>ii</sup> Bates Wells Braithwaite – Choosing your legal form