



National Audit Office

Report

by the Comptroller
and Auditor General

Ministry of Justice, HM Prison & Probation Service

Investigation into changes to Community Rehabilitation Company contracts

Key facts

£64m + £278m = £342m

additional fee for service paid by the Ministry of Justice (the Ministry) to CRCs in 2016-17 (£42 million) and 2017-18 (£22 million)

additional projected payments by the Ministry to CRCs after changes to the contracts taking effect from 1 August 2017

additional fee for service that the Ministry would pay CRCs from August 2017 (up to 2021-22) after its additional fee for service payments in 2017-18 and its adjustments to the payment mechanism

- 21** number of Community Rehabilitation Companies (CRCs) in England and Wales
- £3.7 billion** maximum projected fee for service that the Ministry would pay CRCs when the contracts became operational
- £2.5 billion** maximum projected fee for service the Ministry would pay CRCs from August 2017-18 (up to 2021-22) after its additional fee for service payments in 2017-18 and after its changes to the contracts
- £443 million** total forecast losses expected by CRCs in March 2017, from 2016-17 to 2021-22
- 77%** the Ministry's revised assumption in the contracts of the proportion of fixed costs in CRCs – the original assumption was 20%
- £567 million** the Ministry's maximum projected payments to CRCs under payment by results over the life of the contracts

What this investigation is about

1 Probation services are overseen by HM Prison & Probation Service (HMPPS), an executive agency of the Ministry of Justice (the Ministry). The purposes of probation services are to:

- protect the public;
- reduce reoffending and rehabilitate offenders;
- carry out the proper punishment of offenders; and
- ensure offenders are aware of the impact of crime on victims and the public.¹

2 In June 2014 the Ministry introduced its Transforming Rehabilitation reforms. It dissolved 35 self-governing probation trusts and created a public sector National Probation Service and 21 Community Rehabilitation Companies (CRCs). CRCs supervise offenders who present a low or medium risk of harm, while the National Probation Service manages offenders who present higher risks. In February 2015, following an extensive procurement, the CRCs were transferred to eight, mainly private sector, suppliers working under contracts managed by the National Offender Management Service (now HMPPS). The contracts run to January 2022.

3 The purpose of the Ministry's reforms was to:

- open up the market to a diverse range of rehabilitation suppliers from the private and voluntary sectors;
- incentivise innovation, paying suppliers by results for reducing reoffending; and
- extend statutory rehabilitation to those serving sentences of less than 12 months.²

4 We last reported on the reforms in April 2016.³ We found that CRCs' activity volumes were lower than the Ministry expected during the procurement, which, if translated into reduced income, would affect the ability of CRCs to transform their businesses. We also identified that income shortfalls would affect CRCs' capacity to introduce new ways of rehabilitating offenders. We recommended that the Ministry should regularly review how it paid for services, to ensure that it incorporated and incentivised innovative approaches to reducing reoffending. We also recommended that the National Offender Management Service (now HMPPS) needed a deeper understanding of the financial and service viability of CRCs.

1 Comptroller and Auditor General, *Transforming Rehabilitation*, Session 2015-16, HC 951, National Audit Office, April 2016.

2 See footnote 1.

3 See footnote 1.

5 The Committee of Public Accounts' subsequent report found that the negotiations to resolve the issue of CRCs' reduced activity volumes were undermining the objectives of the reforms.⁴ It recommended that the Ministry should review and adapt the way CRCs are paid for their work to create stronger incentives for them to provide innovative services that meet the needs of all groups and reduce reoffending. The Committee asked the Ministry to keep it updated on negotiations to resolve the difficulties associated with lower activity volumes.

6 In February 2016, the Ministry launched a probation system review. Its purpose was to identify and implement changes that would help to achieve the reforms' aims. The review addressed several areas, but focused primarily on the payment mechanism within the contracts.

7 In 2017, the Ministry took action to ensure continuity of probation services in England and Wales by amending its contracts with CRCs to improve their financial stability. In May 2017, it published its intent to modify the contracts in the Official Journal of the European Union. These changes would alter the payments the Ministry would make to CRCs from 2017-18.

8 The Secretary of State for Justice announced in July 2017 that the probation system had "encountered unforeseen challenges" and that the Ministry had "adjusted the CRCs' contracts to reflect more accurately the cost of providing critical frontline services".⁵ The contract changes took effect from 1 August 2017 for most CRCs.

9 In August 2017, we received correspondence expressing concerns about the transparency of the contract changes in the context of CRCs' performance. We have produced this report to set out the facts in relation to:

- why the Ministry adjusted CRCs' contracts (Part One);
- how the Ministry adjusted the contracts (Part Two); and
- the financial and other implications of the adjustments to the CRCs' contracts (Part Three).

10 We did not examine the value for money implications of the contract changes.

⁴ Committee of Public Accounts, Transforming Rehabilitation, Seventeenth report of Session 2016-17, HC 484, September 2016.

⁵ Ministry of Justice, Probation reform: open letter from the Secretary of State for Justice, 19 July 2017.

Summary

Key findings

Why the Ministry of Justice (the Ministry) adjusted Community Rehabilitation Companies' (CRCs) contracts

1 The volumes of activity CRCs are paid for are well below the levels expected when the contracts were let, while the number of offenders supervised has increased. The CRC contracts specify different payment bands for providing different types of rehabilitation services. CRCs are paid on the basis of weighted volumes that reflect these differences. In 2015-16, the actual weighted volumes of activity undertaken by CRCs ranged from 8% to 34% less than originally anticipated. This pattern has continued in the first quarter of 2017-18, with volumes of activity from 16% to 48% less than originally anticipated. The Ministry believes that this is explained by differences in the types of criminal cases heard by the courts and changes in the requirements attached to offenders' sentences. At the same time between the first quarters of 2015-16 and 2017-18, the number of offenders supervised by CRCs increased by 20% (paragraphs 1.3, 1.5 and Figure 3).

2 The Ministry projected that the maximum it would pay CRCs for rehabilitation services over the duration of the contracts had decreased from £3.7 billion to £2.1 billion. Most CRCs' income is paid for their activities supervising offenders, based on the weighted volumes of work that they do, termed 'fee for service'. When we reported on the Transforming Rehabilitation reforms in 2016, the Ministry projected the maximum fee for service it would pay CRCs over the life of the contracts would be £3.7 billion. The reduced volumes of activity CRCs are paid for led the Ministry to project in 2016-17 that, if the terms of the contracts were applied, the maximum fee for service it would pay CRCs would be £2.1 billion (paragraphs 1.3 and 1.4).

3 By the end of 2016-17, the Ministry had paid £956 million to CRCs in fees for service, £42 million more than it would have done had it applied the terms of the contract. The lower weighted volumes of activity meant that contractually the Ministry could have paid CRCs less. Under the terms of the contract, the Ministry would have paid CRCs £351 million in fees for service for 2016-17. CRCs told the Ministry, however, that they could not maintain existing levels of service if they were paid at lower rates. In response, the Ministry paid CRCs £393 million for their work in 2016-17 (paragraphs 1.6 and 1.7).

4 In July 2016, the Ministry concluded that adjusting the payment mechanism in the CRC contracts should be an immediate priority. The Ministry undertook further work with CRCs to understand the impact of lower than expected weighted volumes of activity, and to explore the options to address the issue. It concluded that CRCs' falling income was contributing to the delivery of poor quality basic services in the contracts (paragraph 1.16).

5 By the end of June 2017, CRCs had met one-third of the performance targets set by the Ministry. The Ministry expected CRCs to be meeting 24 targets from the end of February 2017. By the end of June 2017, CRCs had met eight (33%). By this point, the Ministry had raised service credits with an overall value of £7.7 million, and it had applied £2 million of these in deductions from its payments to CRCs. The remaining service credits were reinvested by CRCs back into services, waived or are subject to ongoing negotiations. HM Inspectorate of Probation and HM Inspectorate of Prisons have also raised concerns about the financial stability of CRCs and the quality of rehabilitation services (paragraphs 1.8 to 1.12 and Figure 4).

How the Ministry of Justice adjusted Community Rehabilitation Companies' contracts

6 Between October and December 2016, the Ministry sought to stabilise the CRC contracts and improve operational performance. The Ministry developed a range of options to change the contracts. It considered their likely impact on the performance and continuity of the contracts, value for money and other factors such as having to instigate a new procurement, affordability and the risk of legal challenge. It chose to adjust the payment mechanism to allow it to alter the way in which its fee for service payments to CRCs changed in relation to CRCs' costs. The Ministry had sought to transfer volume risk to CRCs through the contracts, and secured parent company guarantees to provide financial protection to the taxpayer should CRCs seriously underperform, fail outright or become insolvent. It chose to change the contract to maintain the continuity of probation services on the grounds that the scale of drop in activity volumes was unforeseen by both the Ministry and CRCs (paragraphs 2.1 to 2.3).

7 Throughout February 2017, the Ministry commissioned external assurance work to better understand the financial positions of the CRCs. CRCs were asked to submit financial returns based on written guidance provided by the Ministry, which challenged the returns. The returns reported:

- total projected losses of £443 million from 2016-17 to 2021-22 across all CRCs if the contracts continued without any changes (paragraph 2.5);
- fixed costs were higher than CRCs had anticipated during the procurement – CRCs reported that, on average, 77% of their costs were fixed, compared with the Ministry's original assumptions of 20% agreed in the contracts (paragraph 2.6); and
- the percentage of fixed costs varied between CRCs from 44% to 99.8% (paragraphs 2.5, 2.6 and Figure 5).

8 The Ministry concluded that it and bidders had overestimated CRCs' ability to reduce their costs, and amended the contracts to recognise this. The CRC contracts define how fees paid to CRCs change in line with weighted volumes of activity through the marginal adjustment factor (MAF). The Ministry amended the MAF to take account of the higher than expected fixed costs reported by the CRCs. It made this decision so that, if CRCs' activity volumes fell further, the amount the Ministry paid to CRCs would fall at a slower rate. The Ministry applied the same assumption that 77% of costs were fixed to all CRC contracts (paragraphs 2.7, 3.2 and Figure 6).

The financial and other impacts of the changes to Community Rehabilitation Companies' contracts

9 While it was negotiating the contract change, the Ministry paid 14 CRCs additional fees of £22 million. Before it implemented changes to the contracts, the Ministry paid 14 CRCs increased fee for service payments of £22 million for the period 1 April 2017 to 31 July 2017. The Ministry did this because its 2016-17 agreements (paragraph 3) would have expired before it could agree on and implement the contract adjustments. These payments reflected a weighted volume of activity that was higher than the CRCs' actual positions (paragraph 3.1).

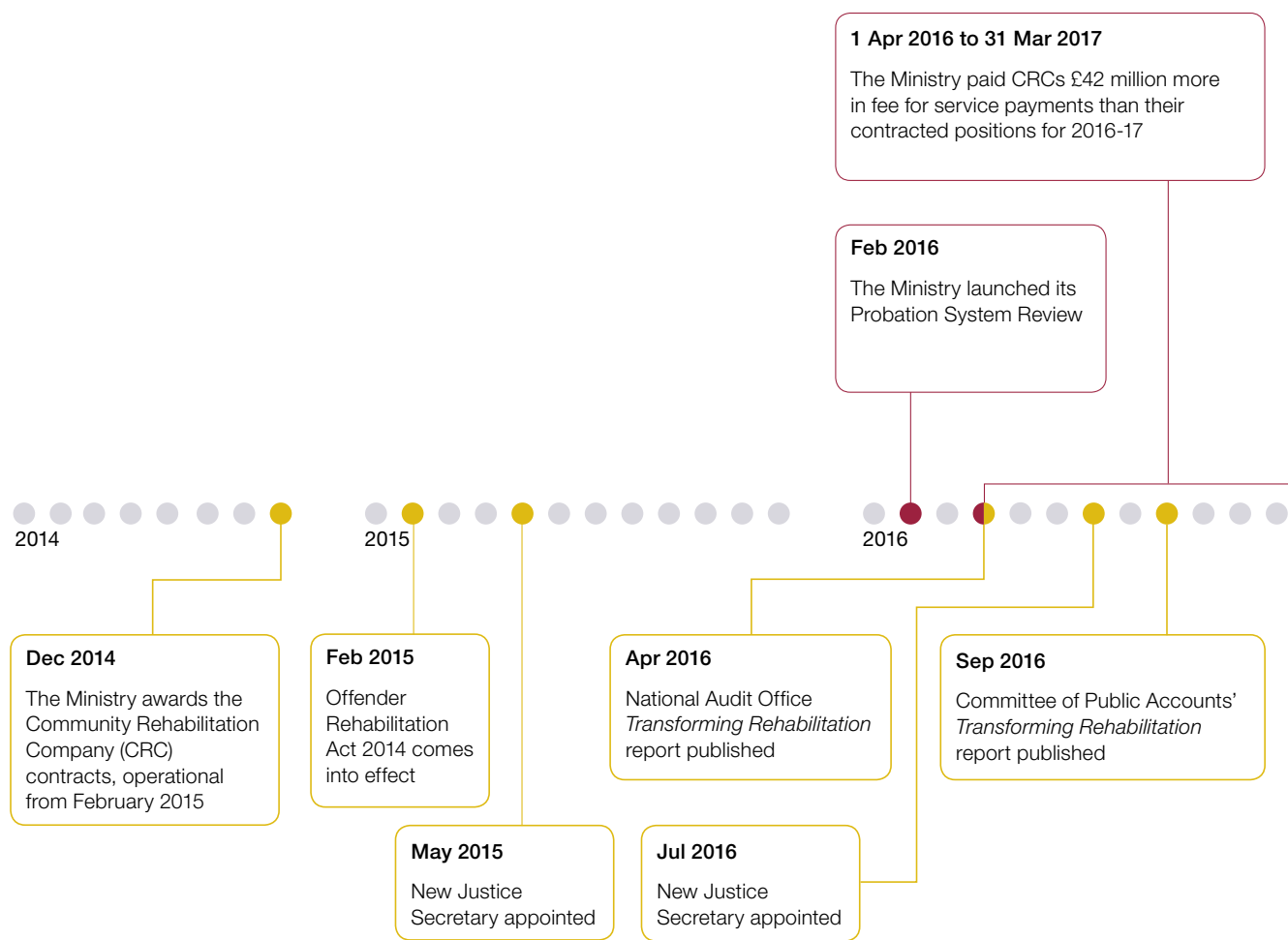
10 Following the contract adjustments, the Ministry's maximum projected payments to CRCs for rehabilitation services increased by £278 million. The Ministry signed variations to the contracts on 6 June 2017, which became effective for most CRCs from 1 August 2017. The changes increased the Ministry's maximum projected payment to CRCs for fee for service over the life of the contracts by £278 million. Combining this with the additional payments of £42 million and £22 million gives total additional projected payments of £342 million. The Ministry estimates the maximum fee for service payments will increase to £2.5 billion. This is below the £3.7 billion projected in 2016 but covers much lower volumes of activity than projected at that time. The increased maximum projected payments to CRCs are below the Ministry's estimates when the contracts were awarded (paragraph 3.3).

11 The impact of the contract change affects different CRCs to different degrees. The Ministry applied its change to the MAF equally to all CRCs, but its impact will depend on the financial position of individual CRCs:

- The Ministry's maximum projected payments to CRCs arising from the adjustments range between £6 million and £37 million (paragraph 3.4).
- The increase in the Ministry's projected payments to CRCs does not cover forecast losses for the majority of CRCs. Increases in maximum projected payments are higher than forecast losses for seven CRCs, and lower than forecast losses for 14 CRCs (paragraph 3.5 and Figure 7).

12 As the contracts progress the level of income CRCs receive will increasingly depend on their success at reducing reoffending. The Ministry included payment by results arrangements to incentivise innovative approaches to reducing reoffending. The maximum projected payments to CRCs through payment by results is £567 million. This represents 18% of total projected payments over the life of the contracts, but this proportion increases from 6% in 2015-16 to 28% in 2020-21. Initial reoffending data for England and Wales since the Transforming Rehabilitation reforms show a 2.2% reduction from the rate in January to March 2011. However, the frequency of reoffences per reoffender appears to be increasing. Initial results show that 13 of the 21 CRCs have made statistically significant reductions in the reoffending rate in the first quarterly cohort, when compared to 2011 baseline reoffending rates. The first performance payments to CRCs informed by reoffending data are due in January 2018, when the data on frequency of reoffending are published (paragraphs 3.6 to 3.8 and Figures 8 and 9).

Figure 1
Timeline of events for changes to Community Rehabilitation Company contracts



- Wider events
- Contract change events

Note
1 Changes to CRC contracts for six CRCs owned by Sodexo became effective on 1 July 2017.

