The Chartered Institute of Public Finance & Accountancy

EDINBURGH TRAM INQUIRY

REVIEW OF FINANCIAL MANAGEMENT AND GOVERNANCE

REPORT

JANUARY 2018

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Certificate No. 5631/06

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1. Executive Summary

1.1 In January 2017, the Edinburgh Tram Inquiry commissioned CIPFA Business – Finance Advisory (the commercial arm of the Chartered Institute of Public Finance and Accountancy) to provide a report on the financial management and governance of the Tram Project.

1.2 Whilst we express certain views in this report, on the basis of the evidence available to us, the purpose of this report is to avail Lord Hardie, as the ultimate fact finder and decision maker, in coming to his own views in these matters on the basis of all of the evidence before him.

1.3 This report outlines CIPFA's position on this work to January 2018.

Context

1.4 The Edinburgh Tram Project was one of Scotland's largest capital projects. The City of Edinburgh Council (CEC) approved a new transport strategy in 2001 incorporating the reintroduction of trams. In 2002 a CEC wholly owned company Transport Initiatives Edinburgh (Tie) was formed to specifically deliver such a transport strategy. The Scottish Executive Transport Minister granted funding of some £375 million for the development of a Tram network and in 2006 Bills to construct a tram loop connecting Granton and Leith to the city centre as well as a link from the city centre and Edinburgh Airport at Turnhouse received Royal Assent.

1.5 In 2007 the Scottish Government approved a revised grant of £500 million with CEC agreeing to fund any additional expenditure. In 2008 contracts were agreed with Tie and a consortium of contractors. The first paying passengers boarded a route (substantially reduced from the original concept design) from York Place to Edinburgh Airport on 31 May 2014. The overall project capital cost has been established as £776.5 million (excluding revenue running costs and interest payments on additional borrowing) with CEC funding the balance of £276 million over and above the Scottish Government funding of £500 million.

Approach

1.6 The scope of our assessment of evidence was made against Good Practice Standards on Governance, Financial Management and Financial Reporting in relation to:

- Funding, Borrowing and analysis of Capital Expenditure
- Contract Management
- Financial Management Capability
- Governance – Compliance
- External Scrutiny

Best practice standards

1.7 In order to provide an in-depth desk top review we outlined a range of documents and data sources relevant to our analysis. The Edinburgh Tram Inquiry Team were able to provide CIPFA with full access to a wide range of relevant sources of written evidence in the form of project related documents and witness statements. Using such sources of evidence we were able to assess critical decisions and management practices against relevant standards of best practice that prevailed during the currency of the project. These standards were:

- CIPFA Financial Management Model including prevailing legislative requirements on Prudential Borrowing and Best Value
- The role of the chief financial officer (CFO)in Public Sector Organisations – CIPFA
- CIPFA Governance Mark of Excellence Standard – The Good Governance Standard for Public Services – The Independent Commission on Good Governance in Public Services – CIPFA/Society of Local Authority Chief Executives (SOLACE)

1.8 Due to the integral nature of the role of the CFO within the overall CIPFA Financial Management Model we have outlined our assessment under the two headings of Financial Management and Governance.

Evidence

1.9 Primary sources of evidence consisted of:-

- Document Review
- CIPFA data.

1.10 It should be recognised that this assessment work is carried out on a restricted set of evidence and should not be seen as an indicator of the overall strength of financial management and governance capability at CEC/Tie. The CIPFA Financial Management Model (FM) is the “gold standard” globally for best practice on Financial Management in the Public Services and is used extensively in North America, the Middle East and Australasia. CIPFA has developed the Statement on the Role of the CFO in Public Service Organisations setting out an overarching principles-based framework that is intended to apply to all public service organisations and their CFOs, irrespective of where they work. The Statement draws on established good practice and regulatory requirements, as well as the requirements of CIPFA and other professional accountancy bodies’ codes of ethics and professional standards. In order to assist with the assessment we formulated an approach applying the most relevant statements and supporting questions from the CIPFA FM Model and the Statement of the role of the CFO to various components of evidence in scope.

1.11 Applying the relevant standards of prevailing good practice we were able to identify twelve specific financial management related activities identified from available inquiry evidence which potentially did not meet good practice. In terms of potential causal drivers some of these areas are inter linked. These areas mapped to specific good practice statements were as follows:-

No	Good Practice area
1	Procurement and Financial Management
2	Financial discipline and decision making
3	Funding and strategic financial planning
4	Budget setting
5	Financial and operational performance monitoring
6	Financial performance accountability
7	Risk Management and internal controls
8	Governance oversight
9	Value for Money
10	External Financial reporting
11	Asset Management
12	Financial skills

1.12 Comments on these headings are outlined below (and are discussed more fully later in the report):

Procurement and Financial Management

- Report to CEC Policy and Strategy Committee on 13 May 2008 seeking approval on Financial Close and approval of revised project budget within a financial envelope of £545m lacked appropriate rigour on the reasons for a 'very late' substantial cost increase and risk realignment back to the CEC/Tie client
- Undue impetus to complete financial close – failure to consider delaying/aborting financial close until a more measured strategy could be formulated
- There was a failure to appreciate that significant works were still to be designed and as a result there was an inability to properly deal with procurement issues and risk transfer at financial close
- The 'Benefits of the final deal' put to members in reports to Policy and Strategy Committee on 13 May 2008 and Tram Sub-Committee on 16 June 2008 ("Immediate contract close on preferred terms") were significantly overstated

Financial Discipline and Decision Making

- Failure to fully consider the option of abandonment and contract termination with the consortium at specific trigger points – including consideration of Audit Scotland advice "CEC and Tie will need to consider fully the consequences of alternatives including termination the contract with BBS"[1]. The total (historic cost) value of assets in the CEC balance sheet is £774,112,349. Expenditure up to 2008/09 (31 March 2009) totalled £221,581,646 some 29% of the final grand total. As it was evident in 08/09 that performance/contractual problems were

[1] Edinburgh Trams – Interim Report – Audit Scotland – February 2011 – ADS00046_001 – Page 6

emerging there should have been appropriate focus on the option of termination (if, of course, there were good grounds for terminating the contract)
- Lack of transparency around the precise costs of termination including compensation
- Lack of rigour and transparency around the calculation of economic benefits payback per £1 of costs for final phasing
- Potential undue impact on decision making arising from the accounting treatment of aborted assets and impairment under the statutory framework – Code of Local Authority code of practice on local authority accounting in the United Kingdom 2010/11 based on International Financial Reporting Standards (IFRS) – potentially incorrect assumption that termination would require a full one year charge to the Council's General Fund to 'de-capitalise' expenditure incurred to date of termination
- Potentially incorrect base assumption on £500m of Scottish Government grant funding received and impact on the Council's General Fund due to termination

Funding and strategic financial planning

- Lack of rigour on decision on gap funding by borrowing beyond the original £45m commitment from CEC
- Imprudent assumptions on capital receipts as a source of funding of the 'over run'
- Lack of full transparency on the decision making around CEC financing of project costs beyond Scottish Government funding. Borrowing exposure of project 'over run' of £231.6m beyond revised project budget of £545m. On financing this additional spend there was a shortfall in developer contributions of some £15.5m. This required a total increase in borrowing of £247.2m and this equates to a revenue impact of some £14.3m per annum charged to the CEC General Fund and met by usual sources of Grant, Council Tax and Revenues. This £247.2m of 'over run' and funding deficiency equates to approximately some £429m over 30 years including interest of some £6.6m per annum
- Lack of transparency over the opportunity cost of project strategy as CEC's contribution grows from £45m to £276m- opportunity cost of overrun and project management costs would have had a negative impact on the financing of other CEC services – with a consequential impact on Council Tax payers and CEC service users
- The annual cost to each band D taxpayer (band used for comparative purposes) of the project overrun (over original budget) is approximately £75.43 per annum i.e. if the council had managed the project to its budget it could have either reduced council tax by £75.43 at band D or provided services to the citizens of Edinburgh that would have cost £75.43 per band D
- Disconnect between operational and financial strategies. This became more apparent as the project evolved. It is unclear whether the operational and financial objectives were fully aligned and correlated with the wider transportation strategy

Budget Setting

- Lack of visibility and precision in the costing of risk – risk and contingency allowances
- Lack of granularity/transparency on optimism bias
- Failure to appropriately consider and illuminate revenue running cost implications during the course of the project
- Lack of 'bottom up' budget construction data presented to decision makers
- Lack of stress testing – assumed competency and undue reliance on budgets presented for decision – absence of stress testing of critical assumptions

Financial and operational performance monitoring

- Lack of consistency in the level of financial performance reporting including financial commentary
- Resilience – undue reliance placed on Tie finance team to deliver robust financial performance metrics
- Spreadsheet analysis – evidence points to undue reliance on spreadsheet analysis over system based data – this may have led to resource inefficiencies and escalated the potential for human error

Financial performance accountability

- Lack of consistent ownership of financial performance – failure of CEC to fully own financial performance of the project – as a special purpose vehicle (SPV) Tie seen by CEC as being independent
- No apparent performance appraisal scheme in existence for staff
- No apparent consequences for poor/sub-standard performance

Risk Management and internal controls

- External Audit Report to Members of CEC for the review on 2007/08 Accounts highlighted areas of potential concern including Audit Committee Scrutiny and a required strengthening in Project Management capability. We could find no evidence to see how such concerns were actively addressed.
- CEC placed undue reliance on Tie to manage risks that naturally reverted to CEC
- Potential lack of rigour from the CEC Finance Director as Section 95 Officer in ensuring that CEC's overall financial risks were being effectively managed
- Up until 2011 CEC appeared to lack an ability to deal with poor performance from Tie including a contingency or exit plan
- Tie's banking facilities were provided by CEC to "minimise risk to the company" – this implies that risk was clearly retained by the Council

Governance oversight

- Lack of clarity around governance arrangements to 2009/10

- Unrealistic cultural positioning – failure to fully consider that Tie was an extension of CEC regardless of its actual legal entity status
- Apparent reluctance of Tie to share confidential information with its shareholder – CEC
- Failure of CEC to consider taking full control from Tie
- Significant dissonance between Tie Board Membership and CEC interests to 2011
- Failure to adequately inform CEC members – CEC members were not provided with relevant information in a timely manner "as a result of sensitivities around the ongoing dispute negotiations"[2]
- Positioning of the Finance Director/Chief Finance Office – restructuring within 2010/11 placed the CEC Finance Director as the proper Section 95 Officer[3] as a third tier officer – this is does not conform to HM Treasury and CIPFA guidance on the CFO requiring equal peer status at the equivalent of Board or CMT level. Principle 1 of CIPFA's the role of the Chief Financial Officer in public service organisations includes that the CFO should report directly to the Chief Executive and be a member of the Leadership Team with a status at least equivalent to other members
- Potential lack of rigour over Tie remuneration arrangements – the appropriateness of loss of office compensation and bonus payments for TIE directors was questioned by Audit Scotland in the Report to Members on the 2011/12 Annual Accounts
- CEC Audit Committee (replaced by wider remit Governance, Risk & Best Value Committee) not fully sighted on Tram Performance reports in contravention of agreed governance arrangements[4]

Value for money

- Value for money approach – not fully embedded
- Concentration upon Benefits Realisation rather than full VfM
- Lack of challenge on Tie's annual operating costs within overall project management costs e.g. significant pension cost exposure and lack of scrutiny around staffing structures and consequential costs
- Lack of visibility on comparative analytics of other tram project capital and running costs within Business Case and revised modelling – Manchester and Docklands Light Railway (DLR)

External Financial Reporting

- Material uncertainty around the final project costs quoted by CEC at £776.5m. A revised project cost budget of £776.5m is set out within the notes to the 2010/11 Accounts – the latest final project costs of £776.5m provided by CEC to implementation as at May 2014 lacks detail and requires to be validated

[2] City of Edinburgh External Auditors Report to Members 2009/10 para 84 ADS00049

[3] Local Government (Scotland) Act 1973 Section 95 - every local authority shall make arrangements for the proper administration of its financial affairs and shall secure that the proper officer of the authority (termed the Section 95 Officer) has responsibility for the administration of those affairs.

[4] City of Edinburgh External Auditors Report to Members 2011/12 para 89 ADS00051

- 2010/11 Legal costs associated with mediation and dispute resolution were charged to revenue and may not be reflected within overall project costs
- Lack of transparency around full project costs including CEC management overheads and overall Tie costs
- Uncertainty over the accounting treatment for potential impairment (the costs of the 10 trams appears to be capitalised)over the 10 Trams that were constructed but not required as a result of the decision to reduce the scope of routing to St Andrews Square with a requirement of only 17 trams rather than 27 constructed
- More assurance required over accounting treatment on the capitalisation (and impairment)of some £59.9m of historical claims[5] including some aborted costs associated with Phase 1b and assets beyond St Andrews Square
- Lack of clarification on VAT arrangements – VAT net input recoveries appears to have been initiated through CEC (as the creation of the assets fall upon the balance sheet of CEC) but the vat supply incurred by Tie

Asset Management

- Absence of Asset Registers – CEC would struggle to demonstrate that the information about key assets in its balance sheet that it held and now holds is a sound and current platform for management action
- Lack of Asset Registers inhibits the ability to track impairment valuation issues at granular level – for example we would expect to see that the asset registers would drive the review of capital asset valuations reflecting current asset values and lives, including depreciation, impairment, acquisitions and disposals
- Lack of evidence to suggest that Tram assets were reported within a balance sheet position to CEC decision makers at least on a quarterly basis as required by good practice

Financial Skills

- Expertise assumed – apparent lack of specific financial management competency focus in recruitment, selection and appraisal processes of Tie staff and advisors
- Assumed competency – perceived lack of recognition of the importance of financial management skills for line/operational managers
- Commercial skilling within financial competency – uncertainty whether such skills were tested within the recruitment process for Tie staff – this would include demonstrating adequate skills and experience of complex infrastructure project work
- Financial management competence gaps – no evidence of training needs being assessed
- Appraisal – lack of evidence to show that Tie/CEC staff were being consistently appraised on financial performance

[5] City of Edinburgh External Auditors Report to Members 2010/11 para 38 ADS00050

1.13 CIPFA's guidance[6] on the role of the CFO in public service organisation sets out the key principles in that the CFO:

- is a key member of the Leadership Team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest;
- must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy; and
- must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

1.14 In the context of the above and 'Section 95' responsibilities, we would be of the considered view that the scope of such responsibilities of the Finance Director of CEC would fully extend to the Edinburgh Trams Project. Although such additional responsibilities would necessarily arise over and above the existing wide scope of mainstream CEC activities, we would have expected that suitable arrangements to ensure financial risks were appropriately managed and were put in place within the CEC Finance Team. Available evidence suggests that undue reliance was placed upon the Finance Director and Finance staff at Tie and that scrutiny and direction from CEC was not as effective as it should have been up to 2010/11. That said we understand that the Finance Director of CEC attended almost all of the Tram Project Board/Tram management forums up until his retirement in 2011.

Overall conclusions

1.15 On the basis of the evidence presented to us there appears to have been a significant cultural and management disconnect between CEC and its wholly owned company Tie Ltd which significantly impaired the effectiveness of these arrangements. The inherent assumption demonstrated by some CEC officials within witness evidence suggesting that the Tie special purpose vehicle (SPV) would be able to insulate CEC from the assumption of risk was fundamentally flawed in the context of the political and operational considerations within which this ambitious infrastructure project was being managed.

1.16 We consider that it was premature to deliver a financial close in May 2008 whilst the design was not fully completed and there were delays with the utilities work. Decision makers may not have been fully informed of the potential risks in entering a highly complex contractual position and may have had insufficient time for the numbers to be fully considered. Members were being asked to agree to a contract where the design specification was incomplete with the contractor having an integral role in project design. This position effectively set the foundational conditions for conflict, delay and a significant recalibration of outcomes. However, from 2011 there

[6] CIPFA – The role of the CFO in Public Service Organisations (Appendix 5)

appears to be an appreciable improvement in the rigour applied by CEC in the management of the project.

1.17 The Edinburgh Tram Project was a highly complex infrastructure project where outcomes and their financing were significantly distorted by a wide range of factors including the differing expectations of parties involved, incorrect assumptions on accountability and a fundamental misapprehension on the transfer of risk. There is no evidence to suggest that the City of Edinburgh Council failed to comply with statutory requirements around Prudential Borrowing or Best Value. Local authorities are creatures of statute and the regulatory mechanism in place around financial reporting, prudential borrowing and best value as audited by Audit Scotland is extremely robust covering all 32 local authorities in Scotland. However, in relation to the Tram Project, compliance with prevailing good practice on governance and financial management was found to be variable over the currency of the project and partial at best.

1.18 Governance arrangements were invariably complex, for example – overly complicated reporting lines which were 'blurred' in practice. A combination of overly complex reporting lines, lack of rigour in CEC's oversight of Tie, sub-optimal management strategies and behaviours together with project 'Lock In' conspired to place a significant drag on the ability of the project to be delivered. A renewed focus with stronger arrangements from mid-2011 onwards allowed for a final push to achieve project implementation in 2014. We are strongly of the view that project 'Lock In' was a key inhibiting behavioural factor. Project Lock-in is a behavioural dissonance where objectivity in decision making is impaired due to decision makers and advisers being unable (through behavioural influences) to consider all available options. This tends to happen when commitments or investment made are deemed to be too large to warrant significantly change or termination of a project regardless of the merits of considering such options.

1.19 We do not believe that the option for terminating the project in 2010/11 was given adequate consideration nor was the financial implications and funding requirements arising from meeting the project forecast spend of approximately £776.5m first highlighted in the CEC Accounts of 2010/11. The available evidence does not show that the consequences of such financing by CEC were fully appreciated. Indeed, the approach adopted in securing the borrowing of gap funding of £247.2m beyond the agreed CDC exposure of £45m and the original Scottish Government Grant funding of £500m does not appear to recognise the opportunity costs to CEC of committing such additional revenue financing costs of repayment and interest.

1.20 In terms of prevailing standards of good practice, financial risks were not appropriately managed and it would be difficult to establish the premise that value for money has been delivered on the final project.

1.21 In summary, whilst some aspects of good governance and financial management were in place such frameworks were significantly undermined prior to 2011 by an absence of a robust CEC led strategic planning and contract management capability including operational and financial performance management.

2 Background

2.1 In January 2017, the Edinburgh Tram Inquiry commissioned CIPFA Business - Finance Advisory (the commercial arm of the Chartered Institute of Public Finance and Accountancy) to support the work of the judicially led Edinburgh Tram Inquiry in the assessment of the identification of financial management and governance good practice within evidence collected by the inquiry team. This report outlines CIPFA's position on this work to January 2018.

Context

2.2 The Edinburgh Tram Project was one of Scotland's largest capital projects. Edinburgh City Council (CEC) approved a new transport strategy in 2001 incorporating the reintroduction of trams. In 2002 a CEC wholly company Transport Initiatives Edinburgh (Tie) was formed to specifically deliver such a transport strategy. The Scottish Executive Transport Minister granted funding of some £375 million for the development of a Tram network and in 2006 Bills for the construction of a tram loop connecting Granton and Leith to the city centre as well as a link from the city centre and Edinburgh Airport at Turnhouse received Royal Assent.

2.3 In 2007 the Scottish Government approved a revised funding envelope of £500 million with CEC agreeing to fund any additional expenditure. In 2008 contracts were agreed between Tie and a consortium of contractors. The first paying passengers boarded a route substantially reduced from the original suite of proposals from St Andrew Square to Edinburgh Airport on 31 May 2014. The overall project capital cost has been established as £776.5 million with CEC funding the balance of £276 million over and above the Scottish Government funding of £500 million.

Approach

2.4 The scope of our assessment of evidence was made against Good Practice Standards on Governance, Financial Management and Financial Reporting and included:

- Funding and Borrowing and analysis of Capital Expenditure
- Contract Management
- Financial Management Capability
- Governance – Compliance
- External Scrutiny

Best practice standards

2.5 In order to provide an in-depth desk top review we outlined a range of documents and data sources relevant to our analysis. The Edinburgh Tram Inquiry Team were able to provide CIPFA with full access to a wide range of relevant sources of written evidence in the form of project related documents and witness statements. Using these evidential sources we were able to assess critical decisions and management practices against relevant standards of best practice that prevailed during the currency of the project. These standards were:

- CIPFA Financial Management Model including prevailing legislative requirements on Prudential Borrowing and Best Value
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- CIPFA Governance Mark of Excellence Standard – The Good Governance Standard for Public Services – The Independent Commission on Good Governance in Public Services – CIPFA/Society of Local Authority Chief Executives (SOLACE)

2.6 Due to the integral nature of the role of the CFO within the overall CIPFA Financial Management Model we have outlined our assessment under the two headings of Financial Management and Governance.

Evidence

2.7 Primary sources of evidence consisted of:-

- Document Review
- CIPFA data.

2.8 It should be recognised that this assessment work is carried out on a restricted set of evidence and should not be seen as an indicator of the overall strength of financial management capability at CEC/Tie.

3. Financial Management

3.1 The CIPFA Financial Management Model (FM) is the “gold standard” globally for best practice on Financial Management in the Public Services and is used extensively in North America, the Middle East and Australasia.

Review of evidence against the CIPFA FM Model

3.2 In order to assist with the assessment we have formulated an approach applying the most relevant statements and supporting questions from the CIPFA FM Model to various components of evidence in scope. In terms of our approach, we modified our standard methodology to test only those statements (using supporting questions) relevant to the above key components. The relevant Statements that were considered appropriate to the assessment of the strength of financial management capability covering the above financial management components were identified and used as the prevailing standards to assess compliance. These statements are outlined in Appendix 3 and (19 from 38 statements in total) were categorised as Primary Statements where we would expect the fundamental attributes of good practice to exist, including at a granular level, assessing the strength or validity of some of the important assumptions.

3.3 The organisation’s current financial management position is assessed through comparing its arrangements against best practice financial management statements. Each statement is scored from 0-4 with half point increments, to establish an overall picture of strengths and weaknesses in terms of how such best practice is achieved. The relevant statements used for our assessment are detailed in order of management dimension (the organisation in scope would be CEC and its group):

LEADERSHIP

Statement	Good Practice
L1	The organisation has an effective framework of financial accountability that is clearly understood and applied throughout, from the Board through executive and non- executive directors to front-line service Managers.
L2	The organisation’s leadership allocates resources to different activities in order to achieve its objectives and monitors the organisation’s financial and activity performance.
L3	The organisation integrates its business and financial planning so that it aligns resources to meet current and future business objectives and priorities. Performance management is conducted through measures of service delivery and clear understanding of the costs incurred.
L4	The organisation has a developed financial management strategy to underpin long- term financial health.
L5	The organisation uses financial management expertise in its strategic decision- making and its performance management, based on an appraisal of the financial environment and cost drivers.

L7	The organisation's leadership integrates financial management into its strategies to meet future business needs. Its financial management approach supports the change agenda and a culture of customer focus, innovation, improvement and development.

PEOPLE

Statement	Good Practice
P1	The organisation identifies its need for financial competencies and puts arrangements in place to meet them.
P3	Managers understand they are responsible for delivering services cost effectively and are held accountable for doing so.
P5	Financial literacy is diffused throughout the organisation so that decision-takers understand and manage the financial implications of their decisions.
P6	The organisation develops and sustains its financial management capacity to help shape and support its transformational programme.

PROCESS

Statement	Good Practice
PR1	The organisation identifies and manages its significant business risks. The organisation is risk aware rather than risk averse.
PR2	The organisation has arrangements in place to maintain an effective system of internal control.
PR7	The organisation's financial accounting and reporting meet professional and regulatory standards.
PR8	Budgets are robustly calculated.
PR9	The organisation actively manages budgets, with monitoring and forecasting that is insightful, ensures 'no surprises' and leads to responsive action.
PR10	The organisation maintains processes to ensure that information about key assets and liabilities in its balance sheet is a sound and current platform for management action.
PR11	Collaborative arrangements to deliver services are accountable for their funding and service performance.
PR14	The organisation systematically pursues opportunities for improved value for money and savings through its procurement and commissioning.
PR15	The organisation pursues value for money through active management of its fixed assets.

3.4 Each statement is supported by questions which seek to cover a range of relevant evidence which assists with the scoring. These supporting questions are outlined in Appendix 3 along with the statements they support and provide a level of granularity behind these statements. Each statement has typically 10 supporting questions. As highlighted above statement scoring rises in increments of 0.5 with each area being awarded a score from 0-4 (where 0 means the underlying statements of best practice do not apply at all and 4 means they fully apply). The assessment tests the extent that there is evidence of good practice for each of the statements. Starting from a 'bottom up' position each supporting question is used against available evidence to measure extent that attributes of good practice exists. An indicative statement scoring is created by aggregating the determinations on each supporting question to arrive at a statement score. Independent of the assessment of supporting questions a top down assessment of each statement in scope is made. Both sets of scoring for each statement are brought together and a moderation is applied to arrive at a final statement scoring – hence a bottom up and top down approach is used to arrive at a final scoring. This approach is designed to minimise any subjectivity that may arise.

3.5 It should be noted that this takes into account only evidential sources available to CIPFA during this review – principally document review. A full assessment using our standard methodology of direct interviews, survey and document review may well have delivered a different result. The matrix is based upon CIPFA's scores for each statement, summarised across the three financial management styles and four management dimensions as shown below. The following table outlines scoring relative to the extent to which attributes of good practice statement applies. This is represented in a Red/Amber/Green (RAG) rating:

Scoring - the extent to which statements apply	0.0	Not at all
	0.5	Hardly
	1.0	Hardly
	1.5	Lower than basic
	2.0	Somewhat
	2.5	Mostly
	3.0	Strongly
	3.5	Strongly
	4.0	Fully

3.6 Applying the CIPFA Financial Management Model we were able to identify twelve specific financial management related activities identified from available inquiry evidence which potentially did not meet good practice. These areas mapped to specific good practice statements were as follows:-

- Financial management issues around Procurement – PR14
- Financial discipline and decision making – L5
- Funding and strategic financial planning – L4, L5, L7, PR12
- Budget setting – PR8
- Financial and operational performance monitoring – PR9, L3
- Financial performance accountability – P3, PR11, L1
- Risk Management and internal controls – PR1, PR2
- Governance oversight L1, PR2
- Value for Money – PR13, PR15
- External Financial reporting – PR7

- Asset Management – PR10, PR15
- Financial skills P1

3.7 Our comments on these specific areas are outlined below.

Financial management issues around Procurement – PR14

Supporting Performance	**PR14**	The organisation systematically pursues opportunities for improved value for money and savings through its procurement and commissioning.	**1.0**

3.8 Our scoring is 1.0 from 4.0 on this aspect of financial management. The high level Statement PR14 seeks to test the degree to which the organisation systematically pursues opportunities for improved value for money and cost savings through its procurement and commissioning. Key supporting questions cover the following attributes:

- Does the organisation have procurement capacity
- Does the organisation participate in framework contracts, joint procurement or consortia to exploit economies of scale and market influence?
- Does the organisation evaluate appropriate procurement strategies (e.g. lease, buy or make)? Does the corporate procurement strategy incorporate gateway reviews for high-risk projects? Does the organisation ensure most purchasing is under formal contract and monitor off-contract purchasing?
- Does the organisation have effective and adequately resourced contract monitoring and reporting arrangements in place?
- Does the organisation ensure value for money during the life of a contract through active contract management, creating opportunities for improved methods during long-life contracts?
- Does the organisation seek value for money through encouraging competition and contestability, accessing wider markets, packaging contracts, supply chain management and developing supplier relationships?

3.9 The Procurement Phase of the Edinburgh Tram Project has been deemed to run from 2001 to May 2008 with a number of different forums created to formulate an emerging procurement model as proof of concept and Business Cases were being created along with legislation to be drafted and funding arrangements secured. Tie Ltd was incorporated in 2002 and the procurement strategy developed had the primary intention of transferring risks, as far as could possibly be arranged, to the private sector. The approach taken is well outlined within the interim report provided by Audit Scotland in 2011:

"In forming its procurement strategy, Tie visited a number of other light rail projects, such as the Lewisham extension to the Docklands Light Railway, and sought to learn lessons from these and relevant guidance. For example, the NAO found that the design, build, maintain and operate form of contract which was used in five out of

seven light rail projects in England it examined could result in higher construction costs because consortia might not be best placed to bear all revenue risk of running a light railway system. Tie's procurement strategy was therefore designed to have separate construct and operation contracts. It also sought legal advice on the form of the contracts, including how best the form of the contracts could be used to transfer risks to the private sector where appropriate.[7]

3.10 In order to minimise overall project time delivery and costs Tie created a strategy to let different contracts. This approach included:

- Early involvement of an operator in the design phase of the project
- Undertaking detailed design in advance of the main construction process – early award of the System Design Contract (SDS) was sought to provide early identification of utility diversion works, land purchase and traffic management interventions and the completion of design drawings
- Tendering the utility diversion works as a specific package prior to main trams works – this was typically problematic in Tram schemes – separating utilities diversion from infrastructure works was regarded as more efficient
- Tendering the infrastructure construction (Infraco) and Tram Vehicle construction (Tramco) separately
- One package Infrastructure construction tendering to contain complex civil engineering work including track routing
- Single consortium approach selected to provide focus on overall delivery of construction – with the transfer of SDS and Tramco contracts to the Infraco consortium
- Focus on providing contracts which would maximise fixed cost components
- Agreed rates on utilities diversion
- Incentivisation – full payment only made on successful completion

3.11 This approach included the appointment of contracts under the following five headings extracted from the Audit Scotland Interim Report of 2011[8]:

[7] Audit Scotland – Edinburgh Trams – Interim Report – February 2011 – Page 12 ADS00046 paragraph 25
[8] Audit Scotland – Edinburgh Trams – Interim Report – February 2011 – Page 14 ADS00046

Tram operator: tie appointed Transdev as the tram operator in May 2004 to assist planning of an integrated service network with Transport Edinburgh Limited (TEL), the CEC subsidiary company with overall responsibility for delivering an integrated tram and bus network for Edinburgh. The contract with Transdev was later ended by mutual agreement in December 2009 and CEC now intends that TEL, or a subsidiary of TEL, will be responsible for operating an integrated tram and bus service.
System Design Service (SDS): tie awarded the SDS contract to Parsons Brinkerhoff in September 2005 to facilitate the early identification of utility diversion works, land purchase requirements and traffic regulation requirements and the completion of design drawings. tie transferred the SDS contract to the Bilfinger Berger Siemens consortium (BBS) when the infrastructure construction contract was signed in May 2008.
Utilities diversion: tie appointed Alfred McAlpine Infrastructure Services as the contractor responsible for the diversion and protection of utilities along the tram route in October 2006. Carillion bought-over Alfred McAlpine in December 2007 and assumed contractual responsibility for delivering utilities diversion works. When Carillion completed its agreed work package in late November 2009, **tie** appointed Clancy Docwra and Farrans to complete utilities diversion works.
Tram construction (Tramco): tie signed pre-contract agreements for the supply and maintenance of 27 tram vehicles with Construcciones y Auxiliar de Ferrocarriles SA (CAF) in October 2007. When the infrastructure construction contract was signed in May 2008, **tie** transferred the tram vehicle construction contract to BBS, and CAF joined the consortium.
Infrastructure construction (Infraco): tie awarded the contract for the design, construction, commissioning and maintenance of the tram infrastructure, including rails, overhead power cables and a tram depot to BBS in May 2008. On award of this contract, **tie** transferred the contracts for systems design and tram vehicle construction and maintenance to it.

3.12 In terms of size the Infraco Contract ended up the largest single source of expenditure with approximately 55% of overall project expenditure being aligned to this grouping of activities. – see below [9]:

[9] "Edinburgh Tram Project: Cost of Work completed to Date" CEC02085665

Edinburgh Tram Project Cost of Work completed to Date	2003 - 2017
Cost Categories	**£'000**
Comms and Stakeholder - external comms and media	£2,724
Comms and Stakeholder	£837
Design	£26,690
Infraco	**£425,485**
Land, property and other costs	£31,255
Legal DLA	£3,503
Legal Other	£3,011
Legal - post mediation	£2,271
Off-street infrastructure - other	£19,819
On-street infrastructure - other	£1,439
PM - Management and supervision	£70,115
PM - Accommodation and Support Costs	£14,463
PM - Insurance	£6,060
Ready for Ops - Transdev and Edinburgh Trams Staff	£10,066
Ready for Ops - LB recharges and other costs	£3,097
Ready for Ops - Ticket Machines	£997
Ready for Ops - Others	£560
Utilities - MUDFA	£57,252
Utilities - post settlement agreement	£21,229
Utilities - other	£25,675
Vehicles - construction/fabrication	£23,448
Vehicles - delivery of trams	£4,513
Vehicles - manuals, special tools and spare parts	£4,954
Vehicles - other	£28,676
Vehicles - vehicle design	£2,752
Less: Funding contributions	-£14,408
TOTAL	**£776,483**

3.13 Whilst there was ample evidence to suggest that significant efforts were made by Tie in the formulation of highly considered procurement processes including OGC Gateway review, the main Infraco contract that was agreed with the Bilfinger Berger Siemens (BBS) Consortium at Financial Close in May 2008 was later regarded as being fundamentally flawed by HG Consultants:

"The contract appears to be flawed. The parties are taking advantage of this contract circumstance to suit their own financial position. That situation can only lead to deadlock as it is ultimately unworkable and as a consequence the parties are now tainted with mistrust."[10]

[10] Edinburgh Tram Project – Report Number One – First Observations and Emerging Thoughts – Hg Consultants - 31 January 2011 CEC02083835

3.14 We also understand, contrary to the original Procurement Strategy that:

- The design was incomplete and not all approvals and consents were obtained when the Infraco contract was entered into
- The utility diversions work were not completed before commencement of the Infraco work

3.15 Financial close on the Infraco contract was achieved on 14 May 2008. Witness statement evidence from CEC Director of Finance indicated that late “brinksmanship” was applied by BBS in order to optimise their contractual position. The introduction of the pricing provisions in Schedule 4 and subsequent negotiations around it led to the whole dynamic of the nature of the original contract being changed. Whilst there were late changes to the bid submission the CEC Director of Finance “*... did not see, or seek, the version of the Infraco Pricing Schedule (Schedule 4) in existence at that stage.*[11]” Given the significance of this late change, we would have fully expected the CEC Director of Finance (who was at the core of the financial oversight) to have made himself fully aware of the potential impact of pricing schedule changes. There appeared to be significant pressure to conclude the contract. A report to the Council’s Policy & Strategy Committee of 13 May 2008 by the Chief Executive sought authority to conclude the contract and financial close (CEC01222075). The report advised of a further increase in cost to £512m from £508m and **sought approval for the Chief Executive to instruct TIE to enter into the relevant contracts**. The background to this request to conclude the contract is articulated by the Director of Finance as follows:

“On 13 May 2008 Tom Aitchison submitted a report to the Council's Policy and Strategy Committee (USB00000357). The report advised that the estimated capital cost for phase 1a was now £512m and that, in return for the increase in price, TIE had secured a range of improvements to the contract terms and risk profile (para 2.11, 2.7 and 2.9). The committee authorised the Chief Executive to instruct TIE to enter into the contracts (CEC01222172). I had been involved in drafting this report and had signed the report discussed in paragraph 161 above (CEC01222438).

My understanding of the last minute increase in price was that it was last-minute brinkmanship from BBS. They claimed the increase related partly to additional costs arising from their supply chain and partly as a result of their concern that phase 1(b) might not go ahead. I understood BBS were claiming they had allocated some of their pre-mobilisation costs to 1 (b) on the understanding that it was very likely to go ahead. “

The purpose of this report (USB00000357) was not to reflect the risks and liabilities to the Council arising from incomplete and outstanding design approvals and consents. The report's purpose was simply to advise the committee of the changed commercial position following the Council report on 1 May i.e. the position regarding the new risk

[11] Witness Statement of CEC Director of Finance - Donald McGougan – para 162 TRI00000060

about the overlapping period of construction and approvals was contained in a Council report on 1 May. Members of the Council were advised of the risks and liabilities to the Council arising from incomplete and outstanding design approvals and consents through previous reports to the Council."[12]

3.16 The report clearly asked the Committee to approve authority to enter into a final contract and cover financial close. In terms of eventual significance the real issue was not about the increase in cost to £512m from £508m but the very nature of the contract that both parties had agreed to. In short, members of the Council appeared to have been advised that the Infraco contract was a fixed price but it turned out not to be the case.

3.17 The Policy and Strategy Committee had appropriate authority to provide approval:

However, there was nothing I can recall in the scheme of governance that meant the Policy and Strategy Committee did not have delegated authority to deal with tram issues such as those to be considered on 13 May 2008.[13]

3.18 The rationale for concluding financial close appeared to be centred around continuing delays on negotiating contract terms with BBS in the context of a perception that the project was not moving along a pace whilst significant payments were being made on other contracts. Difficulties in obtaining agreement with BBS on substantive contract terms with a critical objective of maximising risk transference to BBS mean that relationship difficulties and delays were emerging. The CEC Director of Finance articulates the requirement to conclude financial close as follows:

"A deadline for financial close was regarded as essential to bringing an end to this type of BBS behaviour. Having reached agreement again with BBS, the intention was to try and close on those terms as quickly as possible. We did not want to go to a full Council meeting because that would cause delay and open up the window for potential further claims by BBS."[14]

3.19 We further concluded from the evidence available to us that there may have been concern that if Scottish Government Grant allocation had not been used it may have been recoverable and council funded. Although conditions of grant may well have created the potential for grant to be recoverable we could find no evidence that this was likely to occur. We are also not aware of central government grant being recovered from a delivering public entity as a result of non-compliance with grant conditions in the context of an infrastructure project of this size. It is normal practice for grant to be claimed retrospective i.e., after qualifying expenditure had been incurred and appropriate claim control documents certifying the validity of the claim prepared and submitted. In respect of the Tram Project we have not seen any evidence that suggests that grant drawdown from the Scottish Government was made in advance of actual expenditure, Given the way local authorities are able to

[12] Witness Statement of CEC Director of Finance - Donald McGougan – paras 163 to 165 TRI00000060
[13] Witness Statement of CEC Director of Finance - Donald McGougan – para 152 TRI00000060
[14] Witness Statement of CEC Director of Finance - Donald McGougan – para 154 TRI00000060

flexibly manage their cash flows on capital programme work through highly developed Treasury Management practices we do not see that the timing of grant claim would have or should have had any material impact on decision making on the Tram Project.

3.20 Core components of the report to the Policy and Strategy Committee are outlined below:

Capital Cost and Quantified Risk Allowance

2.7 The estimated capital cost of phase 1a, as reported to the Council on 1 May 2008, was £508m, consisting of base costs of £476m and a Quantified Risk Allowance (QRA) of £32m.
2.8 Following the introduction by the contractors of additional cost pressures late in the due diligence process, tie Ltd held negotiations with them to substantiate its requests for contract price increases and to seek to limit the increase. To help reduce the risk of programme delays, the price increase agreed will be paid as a series of incentivisation bonuses over the life of the contract, on achievement of specified milestones. This approach should minimise the risk of delays to the agreed programme of works to businesses and residents of Edinburgh. These changes increased costs by £4m to £512m consisting of base costs of £481.8m and a QRA of £30.2m. The cost increase has resulted in transferring further risks to the private sector. In addition, part of the package negotiated entitles the contractors to an additional payment of £3.2m, should the Council decide not to construct phase 1b of the tram network. This would result in a final estimated capital cost of £515.2m should phase 1b not proceed.

Benefits of the final deal

2.9 In return for the financial amendments, tie Ltd has secured a range of improvements to the contract terms and risk profile. [15]

2.10 The improvements to the contract terms and risk profile are:

• Immediate contract close on preferred terms • Elimination of risk of claims arising from works underway • Capping of road reinstatement cost exposure • Capping of roads related prolongation • Entry of Construcciones y Auxiliar de Ferrocarriles SA (CAF – the Tram Vehicle Supplier) into the Consortium
In summary, the late price pressure has been contained at £4m as a result of the items noted above. These additional costs have been offset, in part, by a reduced risk exposure. A further agreement has also been established that tie Ltd and the Council will underwrite contingent Phase 1b demobilisation costs of £3.2m if Phase 1b does not proceed with the contractors.

[15] Throughout this report underlining and bold text represent emphasis added to quotations from documents

Alternatives Considered

2.11 The very late increase in contract price was clearly undesirable, although an evaluation of the revised proposal concluded that it continued to represent the best option in terms of price, programme and quality. All other options considered would have resulted in extending the time period for financial close by at least three months and so any potential commercial advantage would be more than offset by inflation, additional procurement costs and tie Ltd's own running costs, as well as delaying the commencement of revenue generation from the trams.

3.21 The incentivising aspects of the contract were aimed at minimising delays particularly in the design work. However there was an indication of a perceived level of expediency required to forge an agreement:

"I note at page 8 of "The Report on Infraco Contract Suite" (CEC01312363) a "bonus pot of £1,000,000" to incentivise the production of design is discussed. Although the bonus was a reward for poor performance we were where we were. It was important that we attempted to mitigate the risk of that non-performance going forward. If we hadn't tried to do that then it could have had a further consequence in terms of the construction programme. The bonus pot was to help mitigate against further delays by SOS which could delay completion of the project. It was critically important that that non-performance was rectified going forward."[16]

3.22 The report to members concludes that the contract terms continue to represent best value:

"The estimated final cost for phase 1a of the Edinburgh Tram Network of £512m, with a further contingent payment of £3.2m due, if Phase 1b is not built, remains well within the agreed funding envelope of £545m. While the process to reach Financial Close has been longer than anticipated, the final terms are within 2.8% of the Final Business Case estimate of £498m and 0.8% of the estimated cost reported to the Council on 1 May 2008 (provided that phase 1b is built). It is, therefore, considered that the contract terms continue to represent the best value delivery option."[17]

3.23 In terms of context 'best value' was an initiative introduced by the government in 1997 as a means of encouraging local authorities to improve their performance. It requires authorities to challenge their existing ways of delivering services, compare their costs with other authorities and external bodies, consult with consumers and stakeholders over the services that should be delivered and where appropriate to subject services to competition from outside. This is sometimes referred to as the 4 Cs and is the broad measurement criteria – Challenge, Compare, Consult and Compete. Best value was primarily introduced to an extent as a replacement for the Compulsory Competitive Tendering regime (CCT), although competition has been retained as an element of it. The Local Government in Scotland Act 2003 introduced

[16] Witness Statement of CEC Director of Finance - Donald McGougan – para 141 TRI00000060
[17] Edinburgh Tram - Update on Financial Close - Tram Sub-Committee - 16 June 2008 - Page 3 TRS00017180

a statutory duty of Best Value with effect from 1 April 2003. An extract of the duty to secure Best Value is outlined below[18]:

PART 1

BEST VALUE AND ACCOUNTABILITY

Duty to secure best value

1 Local authorities' duty to secure best value

(1) It is the duty of a local authority to make arrangements which secure best value.

(2) Best value is continuous improvement in the performance of the authority's functions.

(3) In securing best value, the local authority shall maintain an appropriate balance among—

(a) the quality of its performance of its functions;

(b) the cost to the authority of that performance; and

(c) the cost to persons of any service provided by it for them on a wholly or partly

rechargeable basis.

(4) In maintaining that balance, the local authority shall have regard to—

(a) efficiency;

(b) effectiveness;

(c) economy; and

(d) the need to meet the equal opportunity requirements.

3.24 Between 2004 and 2008 Audit Scotland produced Best Value audit reports on all 32 councils and from 2008/09 undertook reviews based on a risk based approach. The first Best Value audit report on The City of Edinburgh Council was published in February 2007 and in May 2013 Audit Scotland produced a report – the Audit of Best Value and Community Planning. There was a follow-up report in December 2014 and the latest Best Value Audit report was published in February 2016. On managing finance Audit Scotland's report on the Audit of Best Value and Community Planning noted:

"Its cumulative debt was £1.4 billion at that date, an increase of 30 per cent over four years. This is due to the purchase of its Waverley Court headquarters building and other properties, to achieve revenue savings, and the tram project. The council is operating within the borrowing limits in its treasury policy. However, the associated increase in borrowing costs will reduce flexibility in future budgets."[19]

3.25 The concept of Best Value is complex and can be seen as more subjective in character and can cover the whole scope of local authority activities. As a

[18] Local Government in Scotland Act 2003 – Section 1

[19] Audit Scotland – City of Edinburgh Council - the Audit of Best Value and Community Planning – part 6 ADS00045

consequence compliance with the duty of Best Value typically relates to judgements on the prevailing arrangements and framework in place to secure delivery of 'best value' overall. Whilst Audit Scotland identifies that the Tram project represented significant challenges to the Council the overall judgement is based on overall activities rather than on one specific area of activity such as the Tram project.

3.26 A report, following contract close, was submitted to the Tram Sub Committee for noting on 16 June 2008. The report to the Tram Sub Committee noted that:

Benefits of the final deal

2.9 In return for the financial amendments, tie Ltd has secured a range of improvements to the contract terms and risk profile.
2.10 The improvements to the contract terms and risk profile are:

- ***Immediate contract close on preferred terms***
- *Elimination of risk of claims arising from works underway*
- *Capping of road reinstatement cost exposure*
- *Capping of roads related prolongation*
- *Entry of Construcciones y Auxiliar de Ferrocarriles SA (CAF - the Tram Vehicle Supplier) into the Consortium*

In summary, the late price pressure has been contained at £4m as a result of the items noted above. ***These additional costs have been offset, in part, by a reduced risk exposure.*** *A further agreement has also been established that tie Ltd and the Council will underwrite contingent Phase 1 b demobilisation costs of £3.2m if Phase 1 b does not proceed with the contractors.*

3.27 The report of 16 June 2008 to the Tram Sub Committee was signed by both the CEC Director of City Development and the CEC Director of Finance and concluded:

Recommendations

4.1 lt is recommended that the Tram Sub-Committee:
(i) notes Financial Close on 14 May 2008 and the updated position on the suite of contracts for the Edinburgh Tram Network.
(ii) congratulates all the staff of tie Ltd, TEL and the Council involved in the negotiations which led to Financial Close.

3.28 Early within the post financial close period it became evident that the contract was not what Tie/CEC thought it was and significant legal advice was sought as a dispute over the interpretation of core aspects of the contract emerged. During the period that ensued it was suggested that the legal advice used by Tie was incorrect and that the approach taken was flawed with tie losing a number of judgements on adjudication against the consortium:

"We finished up with a contract that very senior legal people and adjudicators in the dispute resolution were saying later that they didn't know what it meant. The fact

that it didn't make sense suggests to me that the legal advice from DLA was deficient."[20]

3.29 Tie's belief that it had entered a predominately fixed price contract framework turned out to be erroneous and this is well articulated by CEC's then Head of Legal and Administration (appointed in December 2009):

"The obvious problem was that the design wasn't complete before the contract was let. ***People didn't really know what they were buying****. Everyone knows the utility works were not cleared properly."*
"The bespoke contract was extremely poor. It was riddled with significant drafting problems. The best way of describing it is that this was a contract that was the equivalent of buying a car with three wheels. That was done presumably to enable a certain headline price to be achieved at the time the contract was let. Because of this, the pricing assumptions, I'm assuming, were then introduced. ***This was not, and never was, a fixed price contract. Contract claims were always going to arise because the contract actually expressly says that."***

"As for my views on the INFRACO contract, I'll maybe touch on just some immediate matters. My first view is that, just by looking at page 3 of the Schedule 4 Pricing Assumptions, you could see that this was not a fixed-price contract. You can see some very clear wording that the contract was priced on the basis of pricing assumptions and would lead to claims, almost immediately, after contract signing. You can see that the Pricing Assumptions were not clear."[21]

3.30 We do note however that following significant change of direction in the overall management of the Project in 2011 that the product of significant mediation allowed a more considered approach to procuring and managing the project and that procurement issues were placed on a more stable footing.

3.31 Given the above it is our considered opinion that:

- The report to CEC Policy and Strategy Committee seeking approval on Financial Close and approval of revised project budget within a financial envelope of £545m lacked appropriate rigour on the reasons for a 'very late' substantial cost increase and risk realignment back to the CEC/Tie client
- There was an undue impetus/haste to complete financial close – failure to consider delaying/aborting financial close until a more measured strategy could be formulated. In effect there was insufficient time allowed for appropriate legal and financial scrutiny
- There was a failure to appreciate that significant works were still to be designed and as a result there was an inability to properly deal with procurement issues and risk transfer at financial close (in addition, there appear to have been

[20] Witness Statement of CEC Director of Finance – Donald McGougan – para 141 TRI00000060
[21] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance – Alistair McLean – Paras 35/139/140/141 TRI00000055

significant delays with the utility diversion works).This lack of design within the contractor procurement strategy led to the 'Benefits of the final deal' being significantly overstated to the Policy and Strategy Committee on 13 May 2008 and Tram Sub-Committee on 16 June ("Immediate contract close on preferred terms")

Financial discipline and decision making – L5

3.32 Statement L5 looks at the way financial management expertise is used in strategic decision-making and relates primarily to the degree of financial expertise which is applied to the organisation's strategic decision making – and in this context – decision making around the Trams Contract and the development of financial plans and the provision of appropriate support and challenge throughout the process. Based on the evidence in scope 1.5 against a global average of 2.4 for this statement:

Supporting Performance	**L5**	The organisation uses financial management expertise in its strategic decision- making and its performance management, based on an appraisal of the financial environment and cost drivers.	**1.5**

3.33 From the 2008/09 Annual Report and Accounts of CEC we note that up to 31 March 2009 a total expenditure of some £221,581,646 had been incurred on the project. Following financial close in early 2008 such a level of expenditure indicates a significant level of billing. Given the level of agreed Scottish Government grant funding it is assumed that CEC would have little financial exposure at that stage to substantive project costs. At that stage funding of up to £545m had been agreed with £500m being allocated by the Scottish Government through Transport Scotland and £45m being contributed by CEC. In relation to the CEC contribution it was suggested that developer contributions and capital receipts would make up the bulk of this contribution. However, we understand that within 2008/09 there was a significant dispute emerging over the interpretation of the contract, principally in relation to design risk, the determination and valuation of executed works and the change provisions (i.e. whether BSC were obliged to carry out works that were subject to a change order before an estimate for these works had been agreed). Within 2009/10 the dispute between Tie/CEC and what became the Bilfinger Siemens CAF (BSC) consortium escalated and materially impacted progress and the ability to accurately forecast overall costs. In the review of the 2009/10 Annual Accounts of CEC Audit Scotland noted:

"The terms and conditions of the grant letter with Transport Scotland include a Conditions Precedent which, inter alia, states that the business plan for the tram for the full scope of phase 1a must be delivered within a maximum capital cost of £545m. This condition was satisfied at the time of signing. However, as a

consequence of the on-going dispute with the infrastructure consortium, the Council is examining contingency planning options up to a capital cost of £600m."[22]

3.34 Whilst Audit Scotland did not place a qualification upon the 2009/10 accounts Audit Scotland did raise an "Emphasis of Matter" comment below their overall opinion. This comment was as follows:

"Without qualifying my opinion I draw attention to the disclosures in the Foreword and the Notes to the financial statements on the Tram Project. In view of contractual difficulties there is a lack of clarity on programme and cost. The Council now anticipates that the full scope of phase 1a of the tram project cannot be delivered within the approved level of funding."[23]

3.35 This recognition of a lack of containment of project costs within the original Financial Close position grew further within 2010/11 where the review of the accounts for that year recorded that as "... *of 21 May 2011 some £461m had been incurred on the project*"[24]. The foreword provides the following additional commentary:

"During 2010/11, the contractual disputes that affected construction on the project continued. Contract resolution did not progress the project and as a result of mediation was undertaken during March 2011. As a result of mediation, the contractor and the Council/tie reached agreement to a settlement to build the project from the airport to St Andrew Square/York Place. The additional requirement for funding was reported to and approved by the Council on 2 September 2011. The total revised project cost is now forecast at £776m with the additional £231m being funded by the Council.
Revised governance arrangements have also been put in place for the remainder of the project. The Council has taken executive control of the project and has appointed Turner and Townsend to provide project management support to the Infraco contract. In addition, Transport Scotland will take a more visible role in the project going forward."[25]

3.36 We note from the 2016/17 accounts that the overall Edinburgh Tram Project Costs outturned at £776.481m.

3.37 Within Audit Scotland's Interim Report on Edinburgh Trams – February 2011 the auditor's concerns about achieving a satisfactory outcome and advice thereon were well articulated as follows:[26]

The Edinburgh trams project is at a significant decision point. There is a high level of concern and media coverage about what the project may finally cost and whether a tram network will be realised. Progress is now largely at a standstill although tie is still incurring staff and other project management costs. While tie is aware of the

[22] Audit Scotland Review of 2009/10 Annual Accounts – Page 8 Foreword – Key Note of Dispute CEC02084261
[23] Audit Scotland – Review of the 2009/10 Annual Accounts CEC02084261
[24] Audit Scotland Review of 2010/11 Annual Accounts – Page 9 Foreword – Tram Project CEC02084263
[25] Audit Scotland Review of 2010/11 Annual Accounts – Page 9 Foreword – Tram Project CEC02084263
[26] Audit Scotland – Edinburgh Trams – Interim Report – Page 6 – Key Issues ADS00046 paragraph 10

issues and has attempted to enforce compliance with its interpretation of the infrastructure construction contract, it is imperative that CEC, tie and BBS work together to establish a clear way ahead for the project. The following table outlines the key issues which need to be considered in taking the project forward.

- *The continuing dispute between tie and BBS over the infrastructure construction contract is clearly a matter of public concern. It is vitally important therefore that a cost effective resolution of the current dispute is achieved. In particular, care needs to be taken that a negotiated solution secures value for money for the public purse. It is important that CEC and tie maintain a clear view of the benefits of a negotiated solution when compared against any additional costs which might be incurred.*
- *At the same time, if a satisfactory solution cannot be found from mediation, CEC and tie will need to consider fully the consequences of alternatives including terminating the contract with BBS. This needs to take into account the value of any proposed financial settlement and any project delays which may flow from such action.*
- *Given the circumstances of the project, there is significant concern about what the project may finally cost and whether it will deliver the expected benefits. CEC and tie should continue to work together to develop options for the project which clearly set out costs and timetables for delivery. If an incremental approach to the delivery of the tram system is adopted, tie should update its calculations of the benefits accruing for each extension of the tram line and ensure that the benefits are maximised for the additional costs which will be required. All budgets and option appraisals should be subject to independent scrutiny and verification, with any requirements for overriding confidentiality constraints kept to a minimum.*
- *As tie has indicted that it is unlikely that all of Phase 1a can be delivered for £545 million, it needs to define its strategy for the project to ensure that its commitments and available funding are aligned.*

3.38 A key message in the issues identified by Audit Scotland is that CEC should consider all options including contract termination – subject to termination consequentials being quantified. Witness evidence appears to suggest that such an option was considered but rejected. Indeed, evidence obtained from the Director of Finance suggests that the consequences of project abandonment would have been financially unsustainable:

"The alternative would have been not completing the project and having no capital asset where all expenditure to that point, which had been chargeable to capital account, would have no value and would then be chargeable to revenue. It would have to be written off in one year to revenue, the possibility that, if we didn't partially complete the project and retain an asset, the Scottish Government could ask for the grant to be repaid. That would have resulted in something like, by that time, nearly £500m, (certainly over £400m), being charged to revenue in one year for the Council. That was far beyond any resources reserved for contingency planning that could be

identified at that time. The increased borrowing was very much the lesser of two evils."[27]

3.39 Local authorities have a statutory duty to keep under review the maximum amount that it can afford to allocate to capital expenditure. The Local Government (Scotland) Act 1975 in conjunction with the Local Government in Scotland Act 2003 are generally the prime sources which allow borrowing by local authorities in Scotland. Part 7 – capital expenditure limits – provides the following:

It is the duty of a local authority to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure."

3.40 This element of legislation enables regulations to be made specifying the criteria for the exercise of this duty. The Local Government Capital Expenditure (Scotland) Regulations 2004 highlights the requirement for the application of "*the Chartered Institute of Public Finance and Accountancy Prudential Code for Finance in Local Authorities*." From April 2004, The Prudential Code developed by CIPFA has become by regulation the self-regulatory mechanism or framework to enable this. The Code aims to ensure that capital investment plans of local authorities are affordable, prudent and sustainable – if properly applied by each local authority.

3.41 In the above statement there is an implication that abandonment would require all capital costs to be 'de-capitalised' and fully charged to the revenue account – "nearly £500m, (certainly over £400m), being charged to revenue in one year for the Council". Whilst it is true that capital spend cannot create an asset if it cannot be used or treated as an asset we believe that this stated position is incorrect. International Accounting Standard 16 – Property, Plant and Equipment (IAS16) highlights recognition as :

The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

(a) It is probable that future economic benefits associated with the item will flow to the entity; and
(b) The cost of the item can be measured reliably.

An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred.

3.42 The key point is that if a project was stopped – capitalisation would cease and that the classification of capital or revenue occurs on the day the expenditure is made. In respect of a private sector entity it is expected that the entity's reserves would suffer impairment. However, local authority accounting requirements are set out in the Code of Practice on Local Authority Accounting in the United Kingdom. This code is based on International Financial Reporting Standards. It is our considered view that

[27] Witness Statement of CEC Director of Finance - Donald McGougan – para 272 TRI00000060

whilst the capitalised assets would be impaired and that an impairment loss should be fully recognised (Impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount[28]) such an impairment can be ameliorated by 'statutory mitigation' and spread over future years rather than the CEC General Fund taking a 'one off' charge for the cumulative project asset spend from inception as suggested by the then CEC Director of Finance. <u>To use the spectre of the lack of affordability based on the expected application of accounting treatment which would create a 'one year' charge for all accumulated capital costs from the project inception as a basis to justify carrying on with the project and incurring a further £231m of additional funding is not, in our opinion, appropriate or justifiable.</u>

3.43 A further point for consideration is the extent that grant (part of the £500m) from Transport Scotland had been applied to the point of potential project abandonment and whether Ministers would require CEC to repay such grant that would have been applied to the point of potential abandonment. We understand that agreement was finally reached with the consortium and CEC members agreed a revised route and project cost on 2 September 2011. This is articulated by the CEC Head of Legal and Administration/Director of Corporate Governance as follows:

"I note that on 25 August 2011, the Council were given a further update by way of a report by the Director of City Development (TRS00011725). The report noted that Faithful and Gould had worked with Council officers in validating the base budget for the proposed works. There was a requirement for funding of up to £776m for a line from St Andrew Square/York Place (comprising a base budget allowance of £742m plus a provision for risk and contingency of £34m). Additional funding of £231m was required, which would require to be met from Prudential borrowing, at an estimated annual revenue charge of £15.3m over 30 years (which, applying a discount rate, resulted in a present day value of the additional borrowing of £291m). At the Council meeting, members did not accept officers' recommendations and instead voted in favour of an amendment that a line should be built from the Airport to Haymarket.

At a special meeting of the Council on 2 September 2011, members were provided with a report by Sue Bruce (CEC01891495). After the vote, the Council agreed to build a tram line from the Airport to St Andrew Square/York Place. The meeting was called specifically to reconsider the Council decision on 25 August 2011 as a result of a material change in circumstances. Unlike what was reported in the press, there were two reasons for that. There wasn't just one. One reason was INFRACO were unlikely to agree to go to Haymarket alone. The second one is the one that is reported in the press, which is that TS indicated that they would withdraw the funding should the Council continue to only go to Haymarket. The members had effectively no choice. They had to change their mind.[29]"

3.44 By 21 May 2011 £461m had been incurred on the project. The decision to commit to expenditure of £776m for the revised routing between Edinburgh Airport and

[28] Code of practice on local authority accounting in the United Kingdom – Definitions - 4.7.2 Accounting Requirements WED00000643

[29] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance - Alistair McLean– Paras 128 & 130 TRI00000055

St Andrew Square/York Place was highly significant as the additional funding beyond the £45m committed by CEC to £276m was to be met through long term borrowing and developer contributions with a consequential impact on Council tax payers in servicing this debt as well as the opportunity cost of the foregone capabilities to spend such a sum on other council services – e.g. Social Care. The CEC Director of Finance to 30 June 2011 explains the position of what CEC members were agreeing to on 2 September 2011 and the 'affordability' of the additional borrowing as follows:

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"The report recommended that the Council complete the line from the airport to St Andrew Square/York place at an estimated cost of between £725m and £773m, depending on the risk allowance. The estimated cost in the Final Business Case was not as much as £545m, it was £508m. It was an extremely regrettable outcome that the cost had risen by so much but by this stage, it was essential that we finished up with some kind of asset that was capable of generating revenue surpluses for the future. The whole issue turned on the contract conditions, the inability to force the contractor to carry out works and the lack of clarity about which party was responsible for the costs arising from the November 2007 design to final design.

The Council's increased contribution from £45m in the Final Business Case to between £225m and £273m was again, an extremely regrettable outcome. *Although that was affordable the extra contribution represented opportunity costs in relation to other Council services. Resources now being deployed on the tram project could have been deployed elsewhere. "*[30]

We were able to fund the Council's increased contribution through headroom in the long-term financial plan and revenue surpluses from the TEL business plan plus further prudential borrowing by the Council. That was all detailed in the August 2011 report.

The increased borrowing was very much the lesser of two evils. By this stage our previously identified contingency planning and Treasury Management savings had already been realised. We had identified further savings that were capable of future realisation because of downward movements in long term interest rates. The stability of long term interest rates indicated that the affordability of the additional borrowing was comfortably within the Council's means. This was obviously not something that we would have wanted to put into the public domain or disclosed to BBS before the mediation.

3.45 There was a shortfall in expected developer contributions which were to be used to augment or mitigate any need for additional borrowing to fund the gap. Including this shortfall (estimated to be £15.5m, the consequential additional financing cost to service the additional borrowing to fund the gap was assessed at £247.162m. This works out at approximately £14.3m per annum in principal and interest payments over a thirty year period including some £6.578m in interest per annum. From relevant witness statement evidence it appears that the prevalence of low interest

[30] Witness Statement of CEC Director of Finance - Donald McGougan – paras 272 and 300 TRI00000060

rates and 'headroom' within financial strategy almost helps to justify the decision to proceed regardless of the impacts on Council Tax payers and the opportunities foregone to finance other services. This line of reasoning provided by the then Finance Director of CEC strongly suggests that CEC were unduly influenced by low interest rates and borrowing costs leading to a less rigorous approach being adopted to committing to some £247m of additional costs to allow the project to proceed within the revised Phase 1a reduced line plan.

3.46 There does not appear to be full transparency around the precise costs of terminating/stopping the project. In terms of causal drivers/influencing factors a study by the Institute of Government highlights some common themes within their 2017 report - What's wrong with infrastructure decision making? – Conclusions from six UK case studies. This Report examined why UK economic infrastructure policymaking is weak and how it can be improved. A key observation on one major infrastructure project was the extent of project 'lock-in'. This is a type of behavioural dissonance where objectivity in decision making is impaired:

"That is, perceived political risks, staff fears of openly expressing disagreement and a decision-making process sceptical of innovation, may have conspired to make decision makers reluctant to turn back after making an early commitment."[31]

3.47 As a behavioural concept project 'lock in' is examined in depth within a study of large scale infrastructure projects across Europe and the Institute of Government report identifies academic work that set out to identify causal issues affecting large cost overruns in transportation projects – *Lock-In and Its Influence on the Project Performance of Large-Scale Transportation Infrastructure Projects: Investigating the Way in Which Lock-In Can Emerge and Affect Cost Overruns.* From this work Project Lock In is described as follows:

Lock-in, the escalating commitment of decision makers to an ineffective course of action, has the potential to explain the large cost overruns in large-scale transportation infrastructure projects. Lock-in can occur both at the decision-making level (before the decision to build) and at the project level (after the decision to build) and can influence the extent of overruns in two ways. ***The first involves the 'methodology' of calculating cost overruns according to the 'formal decision to build'. Due to lock-in, however, the 'real decision to build' is made much earlier in the decision-making process and the costs estimated at that stage are often much lower than those that are estimated at a later stage in the decision-making process, thus increasing cost overruns****. The second way that lock-in can affect cost overruns is through 'practice'. Although decisions about the project (design and implementation) need to be made, lock-in can lead to inefficient decisions that involve higher costs.* ***Sunk costs (in terms of both time and money), the need for justification, escalating commitment, and inflexibility and the closure of alternatives are indicators of lock-in.*** *Two case studies, of the Betuweroute and the High Speed Link-South projects in the Netherlands, demonstrate the presence of lock-*

[31] What's wrong with infrastructure decision making? - Conclusions from six UK case studies – by the Institute for Government – page 7 WED00000644

in and its influence on the extent of cost overruns at both the decision-making and project levels. This suggests that recognition of lock-in as an explanation for cost overruns contributes significantly to the understanding of the inadequate planning process of projects and allows development of more appropriate means.[32]

3.48 Aspects of 'lock in' can be recognised within the evidence in scope for the Edinburgh Tram Project. A changing measure which may be read as illuminating the extent of 'lock in' is the changing Benefits Cost ratio (BCR). We understand that Business Case iterations were assessed against prevailing Scottish Transport Appraisal Guidance (STAG) which provides for comparative analysis and ranking of projects. The critical base assumption being that project investment could only be justified if there was an assessed economic payback with a Benefits Cost ratio (BCR) being greater than 1:1. We understand that the BCR for the initial business case which allowed the Scottish Government to allocate funding was assessed as £2.31 per £1 of cost for Phase 1 of the Project.[33] Phase 1a of the Project constituted a line from Leith Waterfront to Edinburgh Airport and it was anticipated that this would provide benefits of £1.77 per £1 of investment. However the final BCR was evaluated as being less than 1 for the final revised route of phase 1a to York Place. This was highlighted within the following witness statement evidence:

"The project was now in a position where the Benefits Cost Ratio (BCR) was less than one*. If we had been in that position at the appraisal stage the project probably would not have been granted national funding. In terms of the further investment that was being proposed in June 2011 stage and the August report, the STAG appraisal guidance indicates that you should ignore sunk costs to determine if the further investment was required or represented a good investment (para 3.61 of the report). The further investment, at that time, for completing the line to York Place was something like £185m. Although the overall project would finish with something less than one in terms of BCR the extra money to be invested resulted in a proposed marginal BCR of 2.21. That showed that the final investment in relation to the additional expenditure required to deliver an asset was justified.* ***However, overall, the project in BCR terms would not be regarded as value for money. I am not aware whether the Council has gone back and measured all the project benefits in the Business Case (e.g. projected benefits from reductions in pollution) now that the costs are all known and tram operations are underway****. "*[34]

3.49 It is interesting to note that reference is made to ignoring sunk costs. This is a prescribed behaviour identified within the project 'Lock In' behavioural study and that the CEC Director of Finance conceded that the project would not be regarded as being value for money in BCR terms. It is likely that in reality BCR analysis was not considered as a major factor in decision making at various decision points in the timeline of the project. This was articulated in the following:

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[32] Lock-In and Its Influence on the Project Performance of Large-Scale Transportation Infrastructure Projects: Investigating the Way in Which Lock-In Can Emerge and Affect Cost Overruns Environment and Planning B: Planning and Design, vol. 37, no. 5, pp. 792-807 WED00000645

[33] Edinburgh Tram Network Final Business Case – December 2007 CEC01395434 CEC02083448 (FBC) and CEC02083446 (council minutes)

[34] Witness Statement of CEC Director of Finance - Donald McGougan – para 301 TRI00000060

"I note that the BCR of phase 1a was 1:1. CEC viewed the revenue risk, in relation to the fare box revenue, and sustainability of the project as being just as important as the capital costs. CEC possibly viewed revenue risk and sustainability as more important than the BCR. BCR had to be looked at to justify the expenditure on a national basis for the grant funding. A BCR of 1:1 was above the threshold and, therefore, CEC were content with the BCR at that stage."[35]

3.50 Whilst we are aware that BCR was reassessed, the fact that BCR was adjusted to eliminate all sunk costs does not provide an appropriate level of rigour to fully evaluate overall economic payback of the overall project. In general sunk costs should normally be ignored for economic decision making purposes but this will depend on whether there is any marginal benefit in relation to the final outcome and an element of proportionality considered within the economic assessment. There is evidence that economic payback modelling did not feature in final decision making.

3.51 Overall, given the evidence highlighted above, in the context of good practice the utilisation of financial management expertise in the strategic decision-making and its performance management of the Edinburgh Trams Project based on an appraisal of the financial environment and cost drivers is regarded as being partial at best and is reflected within our scoring of 1.5 from 4.0.

Funding and strategic financial planning - L4, L5, L7, PR12

3.52 There are four statements that can be applied to determine the strategic financial planning of the Project. The assessment does not evaluate CEC's medium and long term financial planning but will recognise, where necessary evidence around CEC's financial planning as appropriate. Relative statement scoring is weak around the application of financial management expertise into strategic decision making, transformational change and better in the creation of financial stability aligned to longer term financial planning. Our statement scoring is highlighted below:

Supporting Performance	**L4**	The organisation has a developed financial management strategy to underpin long- term financial health.	**2.0**
	L5	The organisation uses financial management expertise in its strategic decision- making and its performance management, based on an appraisal of the financial environment and cost drivers.	**1.0**
	L7	The organisation's leadership integrates financial management into its strategies	**1.0**

[35] Witness Statement of CEC Director of Finance - Donald McGougan – para 29 TRI00000060

		to meet future business needs. Its financial management approach supports the change agenda and a culture of customer focus, innovation, improvement and development.	
Supporting Performance	**PR12**	The organisation's medium-term financial planning process underpins its strategic priorities.	**1.5**

3.53 For the project we could not find one document that consolidated a long term financial and operational planning position. Various iterations of business cases were developed. In December 2010 the CEC Chief Executive submitted an updated business case (CEC01891570) to council by way of formal report which outlined a revised link between St Andrews Square and Edinburgh Airport:

"The report notes that a line from the airport to St Andrew Square was capable of being delivered within the current funding commitment of £545m."[36]

3.54 Scottish Government Grant Funding channelled through Transport Scotland of £500 being augmented by £45m as CEC's contribution. Notwithstanding apparent clarity outlined with the report to Council there was significant doubt expressed about the confidence on the numbers presented:

"In December CEC wouldn't be confident that the line from the airport to St Andrew Square could be delivered within the funding commitment £545m. At this stage we couldn't be very confident about any of the figures because there was no agreed programme, there was no agreed resolution to the commercial issues and there was no indication of changed behaviour from the contractor. Apart from anything else the £545m figure was from three or four months previously. Even with that figure, we could not have had a great degree of confidence because of the position the project was in."[37]

3.55 We understand that the £45m relating to CEC's contribution was originally composed of the following sources:

"The Council contribution of £45 million was set out in a report in January 2006 (CEC02083547). This was subsequently reviewed twice by consultants and was confirmed to be realistic and achievable. The detail for this is set out in the January 2006 report. There was cash worth £2.5 million, land worth £6.5 million, developers' contributions worth something in nature of £10.2 million, developers' contribution of land worth £7.9 million, capital receipts (again from developments) worth £5 million and developer gains and other capital receipts worth £12.9 million."[38]

[36] Witness Statement of CEC Director of Finance - Donald McGougan – para 315 TRI00000060
[37] Witness Statement of CEC Director of Finance - Donald McGougan – para 271 TRI00000060
[38] Witness Statement of CEC Director of Finance - Donald McGougan – para 314 TRI00000060

3.56 We understand that the £45m relating to CEC's contribution was originally composed of the following sources:

The profile of CEC's contribution changed over time. This was due to a number of variables. One was that the economic conditions post-2008 meant that the land in the Council's ownership was worth less. The economic conditions also meant that there was less likelihood of developer contributions. That said, ultimately we were allowed to anticipate developers' contributions for a period of 10 years from the construction of the tramline and borrow against that. £17.6 million had been achieved by June 2011. By the time that I left the Council it was still considered possible to reach the £45m over that 10 year period to come[39]

3.57 After the recession (which was well publicised around 2008) it would be our view that reliance on developer contributions and capital receipts was not prudent as an authority should exercise prudence in relying on future external receipts to augment prudential borrowing.

3.58 As outlined above agreement on committing to a revised routing from St Andrew Square/York to Edinburgh Airport within a cost envelope of £776m required a recognition that CEC funding would need to expand from £45m to approximately £276m. As also outlined it was proposed that the balance of borrowing would be acquired through 'Prudential Borrowing' framework open to all local authorities.

3.59 Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 7 of the Local Government in Scotland Act 2003. Key objectives of the code are:

- To ensure within a clear framework that capital expenditure plans are <u>affordable, prudent and sustainable</u>
- That treasury management decisions are taken in accordance with good professional practice
- That local strategic planning, asset management planning and proper option appraisal are supported
- To provide a clear and transparent framework to ensure accountability.

3.60 In order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code, it sets out a basket of indicators that must be prepared and used. In addition, an authority may wish to use locally determined indicators. The required indicators have to be set, as a minimum, on a three year time frame and are designed to support and record local decision-making, rather than be a means of comparing authorities. Included within prescribed indicators are the following examples:

- External debt – Maximum level of external debt projected
- Ratio of financing costs to net revenue stream for HRA and non-HRA
- Capital financing requirement for HRA and non-HRA

[39] Witness Statement of CEC Director of Finance - Donald McGougan – para 315 TRI00000060

- Capital expenditure for HRA and non-HRA
- Estimate of the impact of capital investment decisions on the council tax and housing rents
- Gross debt and capital financing requirement
- Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services
- Gross and net debt
- Interest rate exposures
- Maturity structure of borrowing
- Total principal sums invested for periods longer than 364 days

3.61 We understand that the consequential impact of borrowing £247.162m (£231.66m over run spend plus £15.5m on shortfall on developer contributions) over 30 years equated to some £14.3m per annum – a total of some £429m in principal and interest payments – interest payments being approximately £6.578m per annum. Whilst under the application of the Prudential Code such borrowing may seem perfectly affordable the annual revenue consequences have a real impact on revenue budgets and would effectively be an opportunity cost relative to other potential service funding initiatives. We understand that the revenue impacts equate to approximately some £75.43 per annum of Council Tax in relation to Band D equivalent tax banding. In context CEC could have either reduced council tax by £75.43 / band D or provided services to the citizens of Edinburgh that would have cost £75.43 per band D by not funding the gap required to complete the project. The additional borrowing interest and impact on Council Tax is outlined in Appendix 4.

3.62 In terms of overall affordability within CEC's long term financial plan witness statement evidence revealed that there was headroom created by a number of factors:

"316. Headroom in the Council's long term Financial Plan arose from the opportunity to re-finance previous debt that had been incurred by the Council. That was due to be fully repaid over future periods. We were able, because of reduced interest rates, to replace the previous debt carrying higher levels of interest with borrowing at more competitive rates. That provided the headroom in the Long Term Financial Plan. In 2011 there was the prospect of Scottish Government grant changes since the way in which revenue grants for councils were calculated were also being reviewed. The change in the Scottish Government national revenue grant arrangement for local authorities was very favourable to both Aberdeen and to Edinburgh.

In summary, a combination of the headroom created through borrowing cost savings and the additional Scottish Government grant supplemented our Long Term Financial Plan. The revenue resources were converted into capital through the workings of the Prudential Framework. [40]

[40] Witness Statement of CEC Director of Finance - Donald McGougan – para 316 TRI00000060

3.63 In terms of options available the following paragraphs give some insight into the prevailing thinking on borrowing for the gap:

"I have been asked if the additional borrowing for the Tram Project can properly be described as Prudential Borrowing. The increased borrowing for the tram project beyond the £25m already borrowed to meet the Council's contribution of £45m was required to complete an asset which was considered capable of generating future revenue surpluses. The extra borrowing was therefore certainly prudent. The alternative would have been not completing the project and having no capital asset where all expenditure to that point, which had been chargeable to capital account, would have no value and would then be chargeable to revenue. It would have to be written off in one year to revenue. The possibility that, if we didn't partially complete the project and retain an asset, the Scottish Government could ask for the grant to be repaid. That would have resulted in something like, by that time, nearly £500m, (certainly over £400m), being charged to revenue in one year for the Council. That was far beyond any resources reserved for contingency planning that could be identified at that time. The increased borrowing was very much the lesser of two evils. By this stage our previously identified contingency planning and Treasury Management savings had already been realised. We had identified further savings that were capable of future realisation because of downward movements in long term interest rates. The stability of long term interest rates indicated that the affordability of the additional borrowing was comfortably within the Council's means. This was obviously not something that we would have wanted to put into the public domain or disclosed to BBS before the mediation."[41]

3.64 When CEC agreed to contribute £45m the final exposure would not have been in contemplation. Whilst favourable financial planning conditions allowed for the financing of gap expenditure of £231m there is a still an on-going revenue implication which will be faced by CEC. Due to a lack of transparency around discussions surrounding potential other funding options we are unable to form a view on whether there was a sufficiency of rigour in minimising the financing of the eventual gap through prudential borrowing.

3.65 Our evidence points to there being a disconnect between operational and financial strategies over the timeline of the Trams project. From the initial visioning on transport policy for Edinburgh and the Lothians with the Edinburgh Airport Rail Link (EARL) and the integration of bus and tram services through to the eventual final positioning of the Tram project there appeared to be a divergence between the strategy and the actuality in terms of the final solution on the Tram Project. It could be argued that expediency and available finance created the opportunity to fund the Tram Project. Assuming all running costs are recovered by the Tram operator there should be no adverse impact on financial strategy in the short term. Given the complexities involved in this transportation project we would reserve judgement on medium and longer term impacts – particularly if related asset management is sub-optimal.

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[41] Witness Statement of CEC Director of Finance - Donald McGougan – para 315 TRI00000060

Budget Setting – PR8

3.66 The key issue on statement PR8 is whether or not the budgets produced are robust.

Securing Stewardship	**PR8**	Budgets are robustly calculated.	**1.0**

3.67 A key aspect of good practice includes for the degree to which an assessment of risk covering key components of expenditure inform budget setting, reporting and informing decision makers on financial implications, mitigating actions and contingency provisions. Whilst it is clear that significant work had been undertaken at various stages of the project to produce bottom up granular project cost estimates the lack of precision over the exact project specification would mean that the strength of budget construction was always going to be less than robust.

3.68 There was significant changes in project cost projections throughout the timeline of the project. A key aspect would include a risk contingency. It is practice for such a contingency to include an element of optimism bias.

3.69 It is good practice to adjust assumptions about costs, benefits and timing to allow for optimism bias. HM Treasury Green Book Appraisal and Evaluation in Central Government is the benchmark guidance for project cost and benefit evaluation. The introduction to the Green Book explains its scope:

"All new policies, programmes and projects, whether revenue, capital or regulatory, should be subject to comprehensive but proportionate assessment, wherever it is practicable, so as best to promote the public interest. The Green Book presents the techniques and issues that should be considered when carrying out assessments."[42]

3.70 The Green Book provides valuable guidance across all issues that face project evaluation. A contingency against risk is optimism bias. The rationale for considering this contingency is outlined in the Green Book Supplementary guidance as follows:

"1.1 There is a demonstrated, systematic, tendency for project appraisers to be overly optimistic. To redress this tendency appraisers should make explicit, empirically based adjustments to the estimates of a project's costs, benefits, and duration.
1.2 As discussed in the Green Book, it is recommended that these adjustments be based on data from past projects or similar projects elsewhere, and adjusted for the unique characteristics of the project in hand."[43]

3.71 Our evidence suggests that there was a lack of transparency in the costing of risk and the quantification of contingency. The worst case scenario would be that the risk contingency was used as a balancing item within an overall budget deemed acceptable within the overall budget modelling process.

[42] HM Treasury – Green Book – Page 1 CEC02084256
[43] Witness Statement of CEC Director of Finance - Donald McGougan – para 313 TRI00000060

3.72 By any standard such transformational change is highly significant and the financial impacts are obviously based on core assumptions which have been created. Fundamental to the creation of accuracy of assumptions is the requirement to have an absolute understanding of the core components of cost and the cost of risk. Given that the Infraco contract agreed on financial close in May 2008 was based on the erroneous premise that the bulk of the contract was fixed price the relative accuracy of budgets and forecasts was always going to be challenging. Despite such challenges there was some confidence within CEC that business case construction and associated budgets was robust:

"CEC reviewed the Business Cases and the estimates for capital and for revenue implications to ensure, as far as possible, that the process for arriving at the costs had been properly undertaken and was robust."[44]

3.73 Outwith long term prudential borrowing an expected level of resources was expected to come to the Trams Project through developer contributions and capital receipts on assets sales. A figure of £45m was estimated to be generated over a 10 year period and this was going to be CEC's contribution to the Tram Project in addition to the £500m from the Scottish Government. As outlined above authorities need to be especially prudent in relying on future external receipts to augment prudential borrowing.

3.74 Whilst there was significant and continuous work undertaken by Tie in the formulation and revision of estimates the evidence within our scope does not allow transparency in the base estimate construction processes used. However assessments undertaken by external consultants[45] brought on board at the inception of the new Chief Executive point to a number of factors being prevalent in the budget setting process across the project. Picking up on their observations we believe that the following weaknesses were inherent across the range of contracts covering the Trams Project in various degrees:

- Lack of visibility and precision in the costing of risk – risk and contingency allowances
- Lack of granularity/transparency on optimism bias
- Failure to appropriately consider and illuminate revenue running cost implications during the course of the project
- Lack of 'bottom up' budget construction data presented to decision makers
- Lack of stress testing – assumed competency and undue reliance on budgets presented for decision – absence of stress testing of critical assumptions

Financial and operational performance monitoring – PR9, L3

3.75 In relation to PR9, the Model assumes managerial accountability, accurate forecasting of outturns and prompt recalibration of activity takes place when

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[44] Witness Statement of CEC Director of Finance - Donald McGougan – para 313 TRI00000060

[45] Hg Consultants and Turner & Townsend – Project Proposal to Progress within the Contract Programme and present Working Relationships and Behaviours - May 2012 – para 7.2 TRS00023933

needed. Our scoring for PR9 at 1.5 is well below the global average of 2.7. The questions supporting this Statement cover a number of the issues required for an effective budget performance monitoring process which avoids surprises for decision makers and those in governance roles.

Securing Stewardship	**PR9**	The organisation actively manages budgets, with monitoring and forecasting that is insightful, ensures 'no surprises' and leads to responsive action.	**1.5**

3.76 Supporting questions for this statement are as follows:

- Are financial and managerial responsibilities aligned, with revenue and capital budgets assigned to and owned by individual Managers within a formal scheme of budget delegation?
- Do Managers know the organisation's overall in-year financial position against budget?
- Are Managers held accountable for material deviations from budget?
- Do Managers monitor budgets at least monthly and act promptly and effectively to respond to variances?
- Do Finance Staff produce reports to the Board and the Leadership Team (at least quarterly unless circumstances require closer focus) and Managers (monthly) that are relevant, accurate, timely, well presented and understandable?
- Is monitoring predictive rather than backward looking and focused on large, high-risk or volatile budgets?
- Is monitoring related to operational activity indicators that are lead indicators of spend?
- Does the organisation assess the progress of its capital projects and their impact on cash flow, capital financing, revenue accounts and balance sheet, at least quarterly?
- Are reported variances analysed and used as a basis for taking corrective action?
- Do reports link capital and revenue financial and operational information to give an overall picture of performance?
- Does monitoring of investment schemes identify incidents of delay, project creep and cost overruns?
- Does the organisation provide clear documentation, support and guidance, so that Managers who are budget-holders understand their responsibilities and own their budgets?
- Do Finance Staff evaluate budget variances in terms of overall impact and risk for the organisation's financial position and standing?
- Does the organisation have a clear policy on carry-forward of year-end variances, designed to help resources to be used to best effect?
- Are spending trends and budgets projected over a rolling 12-month period ahead spanning financial years to identify emerging cost pressures and inform future planning?

3.77 One of the keys to "no surprises" budget monitoring reports is that such reports should be predictive rather than solely backward looking. The Tram Project Board period update provided a page with a summary of spend and a commentary. An extract of the Tram Project Board covering some 81 pages – Period 13 report tabled for 14 April 2010 highlights the overall financial position:

> **Cost**
>
> We continue to reflect an outturn estimate of £533.3m, including £6.2m for the cancellation of Phase 1b. However, given the commercial uncertainties with Infraco and continuing delays to the project it is now considered unlikely that the full scope of Phase 1a will be completed within the available funding envelope of £545m. Until the key issues are resolved through the contractual and legal process, it will not be possible to accurately forecast a revised budget outturn.
>
> A detailed costs and forecast briefing was presented to Transport Scotland on 18/01/10, and a further quarterly update took place on 18/03/10.

[46]

3.78 Whilst the period update reports to the Tram Project Board are considered to be comprehensive the exposure to financial strategy and commentary is relatively limited. The Period Financial Management Report does look at trends and provides some focus on causal drivers on variances with some insight provided on underlying issues. However reporting tends to look at the current and previous positions trends and there is little real depth in the financial commentary on the full year-end position impacts and how this fits with existing overall financial strategy.

3.79 This contrasts with the approach on progress review provided by Hg consultants[47] which provides a clear and erudite reporting position and brings operational and financial performance together in a more cohesive way. In this respect there is a clear inconsistency in the level of financial performance reporting including financial commentary used during the management of the project.

3.80 Whilst we are advised that the CEC finance team was always available to challenge and track Tie's financial metrics at a high level there was no duplication of activities. On tracking activities after financial close reliance was placed upon the Finance team within Tie to produce accurate and up to date financial information. Given the emerging challenges with financial modelling and staffing changes arising from Tie's own structural changes we believe that CEC should have acquired more assurance that the figures reported were accurate and that assumptions around forecasting were appropriately stress tested. However, we could find no evidence in scope to suggest that was happening as a matter of course.

3.81 It is unclear as to the extent that historic and predictive financial and operational data was acquired directly from base systems. There is significant evidence of operational and financial monitoring reporting being based on what appears to be 'stand-alone' spreadsheet analysis. Undue reliance on manually manipulated data worked within spreadsheet analysis significantly increases the potential for human error to manifest itself and can disproportionately consume staff resources. This can

[46] Tram Project Board – 14 April 2010 – Report on Period 13 – Page 18 CEC00420346
[47] Hg Consultants – Review of progress and Management of the Project – January 2011 to June 2012 TRS00023933

arise as manually adjusted figures are added to system sourced data – the higher the number of adjustments the greater the potential for error to occur.

3.82 The questions underpinning L3 primarily deal with the link between operational plans and its financial plans and ensuring that operational plans are both realistic and achievable. Our evidence suggests that the lack of linkage between operational financial plans is a weakness. The relevant scoring of 1.5 out of 4.0 is below the latest average global scoring for this statement which stands at 2.4 from 4.0. Evidence from our review strongly suggests that the reporting of target outcomes and related resource utilisation/financial performance was weak with integration of the overall Business Planning with Financial Planning for the Tram Project not being substantially achieved.

Supporting Performance	**L3**	The organisation integrates its business and financial planning so that it aligns resources to meet current and future business objectives and priorities. Performance management is conducted through measures of service delivery and clear understanding of the costs incurred.	**1.5**

3.83 Whilst there were attempts to fully integrate operational and financial planning performance, the lack of certainty on the baseline interpretation of the Infraco contract meant that the level of integration expected by this good practice standard was extremely weak up to 2011. Evidence on progress achieved from 2011 to 2014 pointed to significant improvement in the integration of operational and financial metrics.

3.84 A key supporting question relates to monitoring of performance giving rise to corrective action. To 2011 our evidence in scope suggests that it appeared to be very difficult for Tie to appropriately take action to recalibrate resources to control expenditure to budget relative to project milestones. This is partly reflective of the complexity of the project but the focussed appeared to be set on achieving tactical and reactive positions which inevitably ended in short-term sub-optimal positions being taken.

Accountability for Financial performance - P3,

3.85 Statement P3 covers the responsibility and accountability of decision makers. Given general expectations influenced by fiscal retrenchment, those charged with making decisions with resource management implications are fully expected to demonstrate full ownership of decision making and value for money. This statement is not just about delivering project objectives, but doing so in a cost effective manner. In many organisations we have worked with there is a tendency for managers to believe that they are aware of the need to deliver project outcomes cost effectively, whilst finance colleagues are often less convinced of that awareness in their non-finance colleagues.

Supporting Performance	**P3**	Managers understand they are responsible for delivering services cost effectively and are held accountable for doing so.	**1.0**

3.86 CEC's management of the operational and financial performance of Tie Ltd is a critical area for testing. A key requirement would be for CEC to have effective arrangements for provision, access to and ownership of financial, risk and performance data.

3.87 In respect of statement P3 – key supporting questions are as follows:

- Do Managers' performance targets include measures of cost effectiveness (e.g. savings targets, performance improvements)?
- Are Managers at all levels held accountable for performance and financial outcomes, with meaningful consequences for their appraisal?
- Are Managers at all levels held accountable for the value for money implications of their decisions, with meaningful consequences for their appraisal?
- Are market-like mechanisms developed for internal support services to drive efficiency?
- Are challenge and support from Finance Staff sought and taken account of by Managers in their policy decision and delivery role, and at Board level?
- Do Managers and Finance Staff regularly discuss benchmarks and trends for cost drivers?
- Do Managers actively consider the cash flow implications of the way they do business?
- Does the organisational culture recognise and reward efficiency and cost reduction?
- Do external auditors and inspectors comment favourably on the value for money performance of the organisation?

3.88 Following on the failure to find a competency based framework for financial management we could not find any evidence of a performance appraisal scheme in existence that covered Tie staff and CEC staff associated with the Trams Project. We understand that Tie ltd was founded in 2002 – and that remaining Tie Staff were provided with termination payment in 2011. For the course of Tie's existence in that format we could find no evidence that performance management of staff was implemented and that there were explicit consequences for poor performance. Indeed, an external perspective would include challenging the reality that Tie executives were paid bonuses whilst the overall project was not delivering to expectations/objectives. We also understand that Bonus payments were 'rolled up' within termination payments which has led to some media commentators suggesting that such recipients were rewarded for poor performance.

3.89 On Collaborative Arrangements (PR11) our scoring reflects evidence obtained around the management aspects of accountability for funding and service performance.

Securing Stewardship	**PR11**	Collaborative arrangements to deliver services are accountable for their funding and service performance.	**0.5**

3.90 Good practice in this area extends to going beyond contract management. Key questions supporting this statement seek to determine the degree to which the organisation makes its delivery partners individually aware of their financial management reporting responsibilities and obligations. Whilst these obligations should have been clearly signposted within the prevailing operating agreement between CEC and Tie Ltd it was not evident that there was sufficient rigour being applied by CEC to optimise the benefits of these delivery arrangements.

3.91 Another key question in relation to delivery partnerships, is the requirement that the organisation has effective arrangements for provision, access to and ownership of financial and performance data. In this respect witness statement evidence pointed to a reluctance on the part of Tie Ltd to share key data with CEC:

"I did have concerns about the performance of certain CEC officers in relation to the tram project. I had concerns about the strategy that was being deployed. I had concerns about TIE's project management, TIE's reluctance to provide information to CEC and TIE's reluctance to engage in a positive way with CEC. It did feel generally that people were at sea. At the time I became involved I perceived there to be an inertia, almost a lack of proper control, a lack of productivity or a passiveness that verged on helplessness."[48]

3.92 It is clear that contract management capability across the CEC/Tie relationship was compromised by a number of factors including:

- A lack of financial discipline in shaping and managing the 2008 financial close
- Lack of CEC visibility on the performance management of the 2008 contract and associated emerging risks
- Undue reliance on the Consortium to deliver value for money
- Technical specification driven by the Consortium primarily through a design led specification

3.93 In essence whilst CEC clearly expected Tie Ltd, as an arms-length body set up specifically to manage the project, to provide expert project management it is clear that CEC failed to appropriately manage Tie through the prevailing operating agreement and address failings which were becoming apparent in 2010:

[48] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance - Alistair McLean – Para 70 TRI00000055

"TIE's strategy, their project management and their execution appeared inadequate. They appeared out of their depth"[49]

3.94 There was a consistent lack of ownership of the consequences of decisions and financial performance of the overall contract associated by financial close in May 2008. The significant increase in the pricing, the changed nature of the contract at financial close and a fundamental misunderstanding of the actual contract agreed contributed to inertia around the accountability for operational and financial performance. Arguably this absence of clear leadership and accountability would not have assisted in positively dealing with the impasse associated with the escalated dispute with the Consortium and the subsequent lack of activity on progressing works.

Risk Management and internal controls – PR1, PR2

3.95 Scoring on risk and internal control good practice were lower than our global average scoring of approximately 3.0 from 4.0 for these two statements.

Securing Stewardship	**PR1**	The organisation identifies and manages its significant business risks. The organisation is risk aware rather than risk averse.	**1.5**
	PR2	The organisation has arrangements in place to maintain an effective system of internal control.	**2.0**

3.96 There was a clear perception that risk management across tie and CEC associated with the project was extremely robust:

"Tie produced a primary risk register which they shared with the Council. External reviews indicated that TIE was probably at the leading edge of risk management for project delivery at that time. TIE's approach to risk management was commented upon favourably by both Audit Scotland and the OGC. The register was fit for purpose."[50]

The Council reviewed TIE's arrangements for managing risk. The Council satisfied itself with TIE's approach. TIE was subsequently commended for their risk management processes both by the OGC and by Audit Scotland. In addition to that, Council staff were involved in risk workshops and Council staff participated in the ORA risk review on a monthly basis. The TPB also reviewed the risk register monthly. Risk was fully considered as part of the Business Case approval and the Council reports relating to that. When the project was underway the reputational and

[49] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance - Alistair McLean – Para 143 TRI00000055

[50] Witness Statement of CEC Director of Finance - Donald McGougan – para 337 TRI00000060

potential financial risk from the tram project was very close to the top, if not top, of the Council's risk register."[51]

3.97 An OGC review of Risk [52] formed a positive view that on Tie's Risk management capabilities:

"The tie risk management process is well developed and reflects best practice. A mature risk register is in place together with excellent risk capture and management processes. Advanced Quantitive Risk Analysis (QRA) of capital cost estimates are routinely produced and incorporated into project estimates."

3.98 The OGC review identified a risk contingency of some £49m on an overall project cost estimate:

"We believe that the overall headroom of £49m in the capital expenditure is a prudent provision at this stage of the project development"[53]

3.99 Whilst the 2007 Risk review highlighted some extremely relevant risks and appropriate risk mitigation recommendations such reviews, albeit independent, rely significantly upon the quality of base evidence provided. Whilst Gateway review methodologies are robust – the assessment is indicative and predicated upon the quality of inputs. In the case of the 2007 review the successful implementation of its recommendations would have been extremely challenging and potentially inconsistent with the assessed level of contingency and assurance derived by senior officers connected with the project. It would be our opinion that the review provided more of a 'road map' of the issues that required to be quickly resolved rather than delivering a level of confidence around the probabilities of success. In addition, the OGC review of risk was carried out in October 2007 and a further review of risk ought to have been carried out before contract close in May 2008 given the potential for the risks in the project to have changed over that period including, in particular, as a result of the negotiation of the Infraco contract.

3.100 Whilst there were clearly mechanisms in place, the effectiveness of managing risk, the objectivity in measuring the cost of risk and the agility to react to rapid changes required to be evaluated. It would be our position that evidence points to CEC placing undue reliance on Tie to manage risks that ultimately reverted to CEC - particularly at the point of Financial Close in May 2008. The then CEC Director of Finance outlined his view on risk transference relative to each iteration of the Business Case:

"My understanding about the risks were ***that risk management was primarily a matter for TIE*** *who were required to manage the risks as the project developed and that* ***adequate financial provision for risk would be required at each iteration of the***

[51] Witness Statement of CEC Director of Finance - Donald McGougan – para 363 TRI00000060
[52] Edinburgh Tram Risk Review October 2007 – Page 4 CEC01496784
[53] Edinburgh Tram Risk Review October 2007 – Page 4 CEC01496784

***Business Case**. The revenue side was a risk that clearly was going to sit with CEC i.e. fare box risk."*[54]

3.101 We note that Tie's banking facilities were provided by CEC to "minimise risk to the council"[55]. This position implies that risk was clearly retained by CEC albeit within little overall risk exposure. However it is clear that the level of independence derived from arms-length status did not eliminate any overall risks to CEC for the appropriate management of Tie. Indeed we understand that for Financial Close to proceed CEC required to provide a guarantee on all contractual responsibilities. This was articulated in the following witness statement:

"The subsequent report to Council on 20 December 2007 discussed below (CEC02083448) made clear that the Council sat behind TIE and ultimately carried all the contractual responsibilities. It noted that a guarantee was needed. Section 8 of that report set out on-going matters where work was continuing to ensure an acceptable outcome for the Council prior to Financial Close and allowed for all the risks that were remaining with the Council.[56]"

"Although CEC were guaranteeing the position of TIE, TIE had a direct responsibility to CEC in their company objectives. That was part of the reason why they were set up. On top of this DLA owed a Duty of Care to CEC. I believed DLA and indeed TIE had an obligation to identify any material issues to CEC arising from the negotiations and changes to assumptions in the business case. I am not suggesting CEC relied on that entirely, I am just trying to highlight what was going on at the time between the parties.[57]"

3.102 In 2010 CIPFA published a Statement on the Role of the CFO in Public Service Organisations – see Appendix 5. The Statement draws on established good practice and regulatory requirements, as well as the requirements of CIPFA and other professional accountancy bodies' codes of ethics and professional standards. Within this statement CIPFA expects CFOs to be able to deliver the following principles and we would expect such arrangements to be in place within all public service organisations connected to the Tram Project (this would necessarily include City of Edinburgh Council):

1 - The CFO in a public service organisation is a key member of the Leadership Team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest.

2 - The CFO in a public service organisation must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's overall financial strategy.

[54] Witness Statement of CEC Director of Finance - Donald McGougan – para 24 TRI00000060
[55] Witness Statement of CEC Director of Finance - Donald McGougan – para 89 TRI00000060
[56] Witness Statement of CEC Director of Finance - Donald McGougan – para 67 TRI00000060
[57] Witness Statement of CEC Director of Finance - Donald McGougan – para 136 TRI00000060

3 - The CFO in a public service organisation must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently, and effectively.

3.103 A core CFO responsibility component of principle 2 outlined above is the impact a CFO should have in the decision making process and this is expanded below:
<u>Core CFO Responsibilities - Influencing decision making</u>[58]

- Ensuring **<u>that opportunities and risks are fully considered and decisions are aligned with the overall financial strategy.</u>**

- Providing professional advice and **<u>objective financial analysis</u>** enabling decision makers to take timely and **<u>informed business decisions</u>**.

- Ensuring that the organisation's **<u>capital projects are chosen after appropriate value for money analysis and evaluation using relevant professional guidance</u>**.

- Checking, at an early stage, that innovative financial approaches comply with regulatory requirements.

3.104 Given the issues arising from what we see as undue haste in the approach taken to conclude financial close in May 2008 and enter a contract which was later considered by legal and construction experts to be fundamentally flawed with overall risks being effectively transferred to CEC it is difficult to conclude that CEC's overall financial risks were being effectively managed in accordance with expectations derived from this statement of good practice.

3.105 A key aspect of risk management is assessing the full cost of risk. Within cost estimation across various components of work a risk contingency was effectively assessed and added to formulated cost estimates that would include optimism bias outlined within our assessment of Budget setting. As outlined within our assessment of PR8 – Budget Setting – the level of contingency set at various points within the project time line was considered to be unrealistic – particularly given the inherent complexities of the original contract. There was a sense that such a contingency allowed some flexibility that may have subconsciously allowed for a less rigorous approach to precision around cost estimation.

3.106 At a more basic level a fundamental starting point is the requirement to identify/assess risks and track them within a Risk Register. In relation to Financial Close it was evident that risks were not fully considered in the impetus behind the desire to secure early financial close:

"At that point in time, I did not have a view on the risk register. Since then, I have formed a very clear view on that risk register. My personal view is that it did not

[58] CIPFA - Statement from "the Role of the CFO in Public Service Organisations: (Appendix 5)

cover the risks that materialised. I personally consider that that was a material failing but it's not one I can expand on due to legal privilege."[59]

3.107 The External Audit Report to Members of CEC for the review on 2007/08 Accounts highlighted areas of potential concern including Audit Committee Scrutiny and a required strengthening in Project Management capability. In essence we detected no improvement until appropriate improvement initiatives were put in place in 2011 through the impetus provided by the new Chief Executive and the newly appointed Director of Corporate Services.

3.108 Whilst there was an overlay of governance arrangements around the scrutiny of Tie we could find no objective evidence of formal performance appraisal. As a consequence, critical controls over the formal management of performance between 2007 and 2011 appear to be difficult to find. Indeed, CEC appeared to lack an ability to deal with poor performance from Tie including a contingency or exit plan. This will be expanded upon within our statement on Accountability for Financial Performance.

Governance oversight - L1, PR2,

3.109 Statements L1 and PR2 are considered together. Statement L1 seeks to measure the strength of practical financial accountability from CEC, Tie and related forums associated with the project.

[59] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance - Alistair McLean – Paras 70 TRI00000055

Securing Stewardship	**L1**	The organisation has an effective framework of financial accountability that is clearly understood and applied throughout, from the Board through executive and non- executive directors to front-line service Managers.	**1.0**

Securing Stewardship	**PR2**	The organisation has arrangements in place to maintain an effective system of internal control.	**2.0**

3.110 Scoring on both statements are markedly lower than we would expect to see against global averages of round 3.0. Relevant supporting question relating to statement PR2 are highlighted below:

- Does the organisation monitor and act to ensure compliance with relevant laws and regulations and that expenditure is lawful?
- Does the organisation regularly review its internal control procedures and update them where necessary?
- Does the organisation have structured arrangements in place to obtain the assurance needed to enable the Annual Governance Statement or Statement on Internal Control to be signed?
- Does the Leadership Team take prompt action to remedy any breakdowns in internal control procedures?
- Does the organisation monitor and act to ensure that its Financial Regulations or Standing Financial Instructions (including procurement) are used appropriately?
- Does the organisation monitor and act to ensure compliance with its documented internal control procedures?
- Does the Audit Committee receive and monitor the implementation of internal and external audit recommendations?
- Was the annual audit letter free of weaknesses identified in the operation of internal controls?
- Are Board members and staff aware of relevant codes of conduct and is compliance high?
- Does the organisation have up-to-date procedures to prevent, detect, and investigate misconduct, fraud and corruption?
- Do designated counter-fraud and corruption staff follow formal procedures to investigate suspected fraud?

3.111 There are a number of supporting questions to this statement commensurate with the ‘bandwidth’ of good practice statement L1:

- Does the Board set the tone that finance matters?
- Are there written governance arrangements which define the financial management roles and responsibilities of the Board, relevant governance

groups and of the Chief Executive and senior Managers, underpinned in more detail by financial regulations and contract procedures?

- Is the Board given a consolidated view of the organisation's finances and risks, including from subsidiaries and important deliver partners?
- Does the organisation have an effective Audit Committee?
- Do the organisation's governance arrangements comply with the sector's code of corporate governance, reflecting Nolan standards of ethical behaviour and public accountability?
- Are external audit or inspection reports free from governance concerns?
- Does the Audit Committee receive and monitor the implementation of internal and external audit recommendations?
- Is there a professionally qualified Chief Financial Officer?
- Is the Chief Financial Officer a member of the Leadership Team, reporting directly to the Chief Executive and with direct access to the Board and the Audit Committee?
- Is the scope of the Chief Financial Officer's other management responsibilities reviewed to ensure their focus on financial matters is not compromised?
- Is there a line of professional accountability between those with principal functional responsibility for finance within the business and the Chief Financial Officer, to ensure standards of compliance and objectivity of advice on financial matters?
- Are shared accountabilities and commitments between the Finance Function and other business areas clearly defined?
- Is the external auditor's annual letter considered by the Board and the Audit Committee, with recommendations factored into future years' work programmes?
- Does the organisation publish an Annual Governance Statement or Statement on Internal Control, including internal financial control and risk management, signed by the Chief Executive?
- Is there a published annual report that conforms to appropriate standards and sector requirements?
- Do senior managers demonstrate an understanding of the financial management rules by actually applying them?
- Do decision reports include advice written or signed off by Finance Staff on financial implications and value for money

3.112 We understand that within the formative phase of the Tram Project governance arrangements were regarded as being 'sound'. Indeed Audit Scotland commented within their 2007 Report – Edinburgh Transport Projects Review that:

Arrangements in place to manage the project appear sound with:

- *a clear corporate governance structure for the project which involves all key stakeholders*
- *clearly defined project management and organisation*
- *sound financial management and reporting*

- *procedures in place to actively manage risks associated with the project*
- *a clear procurement strategy aimed at minimising risk and delivering successful project outcomes.*[60]

3.113 Witness statement from the then Chief Executive of CEC outlines the original governance framework and the emerging challenges arising from what was seen as a potential escalation of costs against a fixed Scottish Government Grant:

"I think all those involved in the tram project recognised that there was a degree of complexity in the governance arrangements, with three companies involved – TIE, TEL and Lothian Buses. In addition, a key role was played by the TPB in taking the project forward. The Council took care to appoint individuals with senior commercial experience to the Boards of the companies. And, the relationship between the companies and the Council was set out in Operating Arrangements. Elected members and senior Council officers were also appointed to the Boards to help assist with the co-ordination, co-operation and control needed between the companies and the Council. Board meetings were held regularly and were run professionally. In short, the governance model had been thought through by the Council and was designed to facilitate the development of the tram project and the integration of tram and bus operations.

As noted above, the roles and responsibilities of the key bodies involved in the delivery of the tram project were set out by the Council and individual Board members understood their roles.

As far back as June 2005 it was Council policy to encourage a degree of overlap in the membership of the Boards. Part of the rationale for this was to prepare for the integration of tram and bus operations while the tramline was being built. For example, consideration had to be given to route planning, ticketing policy, IT systems, management and operational arrangements and the like. I don't recall any concerns being raised at the time that the membership arrangements were adversely affecting the independence and objectivity of Board members.

As the tram project progressed and problems arose the "control" arrangements came under strain. While TIE was responsible for the delivery of the tram, the Council was accountable as far as the public were concerned. As noted earlier in this statement, difficulties arose in terms of what could be accurately reported to Council; what would be reported in public; and what steps the Council could take to improve project delivery performance. Increasingly, and throughout 2010 in particular, having TIE operate at "arms¬length" and with a significant degree of independent working was called into question.

TIE was the organisation charged with procuring and delivering the tram project. Its governance reporting line was through TPB and TEL.

I note that on 20 July 2007, Jim Inch prepared a Briefing Paper for me entitled "TIE - Governance Arrangements" (CEC01566497). The paper noted that (i) "it is now vital that more rigorous financial and governance controls are put in place by the Council given the funding cap that has been placed on the project and the greater financial risks that are borne by the Council" (para 4.1); (ii) the current governance controls

[60] Audit Scotland - Edinburgh Transport Projects Review – Para 14 – Page 3 PBH00025857

were "complex" (para 3.1); (iii) combining the roles of Chair and Chief Executive of TIE was seen as a stopgap measure (which had been in place for nearly two years) and was contrary to one of the main thrusts of the Cadbury Code, namely, the separation of the roles of Chief Executive and Chair (page 3); (iv) there was no service contract for Neil Renilson as Chief Executive of TEL (page 3); (v) while the Director of City Development was CEC's Company Monitoring Officer for TIE, in terms of corporate governance it could be suggested that the roles of Company Monitoring Officer and Director of City Development should be separated (page 5); (vi) "TEL is envisaged as TIE's monitor. However the fact of not having any money of its own and being paid by TIE undermines TEL's position" (page 5); (vii) the TPB "is not a legal entity", "there is doubt as to whether the Council can competently delegate its powers to the TPB" and the TPB "which sits outside TEL and TIE in fact has no control over, or makes the decisions" (page 6) and (vii) three options were identified to achieve these enhanced controls, including (a) winding up TIE and bringing the relevant and necessary staff into the employment of the Council; (b) TIE continues to progress the project on the basis of a fully documented principal/agent agreement with the Council and (c) the Council to set up a tram committee, to replace the TPB and essentially performing the current TPB functions. These matters would require to be considered and discussed "at the very highest levels within the Council" (page 8)"[61]

3.114 Whilst we note that there was a prevailing CEC code of guidance which included corporate governance which would have required compliance by Tie[62] there was also in place formal agreements between CEC and Tie which should have provided an effective governance framework[63]. Despite this framework being in place we found some conflicting evidence as to the effectiveness of such arrangements governing the relationship between CEC and Tie;

"The Council ensured that TIE was properly resourced and that TIE had appropriate internal governance arrangements. The Operating Agreements set out TIE's obligations to the Council. The Council reviewed the TIE Annual Business Plans and the Project Business Case at each milestone."[64]

"I am aware that, before my time, certain individuals in the Council were deployed to sit within TIE. I think there was some scrutiny there. In relation to the Tram IPG, if it had a role to oversee TIE, its role was not clear and it wasn't effective.
I did have concerns about the performance of TIE as an organisation.
I don't know the formal mechanics of how the Council's senior officers received information and updates from TIE. I can only say that when I, or my team, sought information from TIE there was a general resistance, more often than not, to providing that information. I did have concerns about TIE's reporting and whether that was always fully and accurately reported." [65]

[61] Witness Statement of CEC Chief executive - Tom Aitchison – para 319-324 TRI00000022
[62] City of Edinburgh Council – Council Companies –Code of Guidance June 2006 CEC02084254
[63] Agreement between City of Edinburgh Council with Transport Initiatives Edinburgh (TIE) Limited 2005 - Third – Company's obligations (3) - CEC00478603_0004
Agreement between City of Edinburgh Council with Transport Initiatives Edinburgh (TIE) Limited – May 2008 CEC01315172
[64] Witness Statement of CEC Director of Finance - Donald McGougan – para 87 TRI00000060
[65] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance - Alistair McLean – Paras 183 TRI00000055

3.115 Whilst a framework was in place regulating the relationship between CEC and Tie it is clear from witness statement evidence that such a framework was not operating correctly and that there was an emerging gap from 2007 to 2011 in the effectiveness of operating controls exercised by CEC over Tie Ltd. Some context is provided within the following witness statement evidence:

"It is probably fair to say that, notwithstanding the relatively clean bill of health Audit Scotland gave the project back in February 2011, there was no clear accountability or clear scrutiny. You can see Audit Scotland's description of the structure at page 34 of their report (ADS00046).

This shows a convoluted corporate structure that was not conducive to clear decision making. It was for that reason that the governance of the project later changed.

The failure of the tram project and other projects in CEC, around about that point in time, was the reason why I introduced a major projects office when I became Director of Corporate Governance in October 2011 (discussed further below). The tram project was excluded from that office. It was treated as a hermetically-sealed project. It was effectively in intensive care for a number of years post-mediation.
I note the letter dated 7 January 2010 (CEC00550621) where I advised Malcolm Reed, Chief Executive of TS, that pursuant to an Act of Council dated 20 December 2009, the Council had transferred ownership of TIE Limited to TEL Limited, and that in terms of the operating agreements in place all significant decisions relating to the tram project would now be taken by TEL through its formal committee the TPB. Day-to-day contract management delivery remained with TIE. ***I would struggle to provide a definitive answer as to which body or organisation took all significant decisions in relation to the tram project prior to CEC transferring ownership of TIE to TEL****"* [66]

3.116 An aspect of this dissonance manifested itself in the lead up to financial Close in May 2008 and in legal positions taken by Tie against the Consortium in the interpretation and enforcement of the contract including Termination Notices (which turned out to be defective). Effectively CEC's interests were not being managed appropriately by Tie Ltd and there were unrealistic expectations from some at CEC who had thought that Tie would insulate the Council from cost and overrun risks. For example, as problems emerged between the Consortium and Tie there appeared to a failure by CEC to fully recognise and consider the true nature of risk transfer post Financial Close:

The accountant's role would be to question the basis of the calculation and to make sure, once the calculation had been done, that the appropriate provision was sitting in the risk allowance that had been allocated to the project. I expect the base calculations and assessments were being done by the people who had negotiated the contract and were managing the contract within TIE.[67]

[66] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance - Alistair McLean – Paras 146 – 148 TRI00000055
[67] Witness Statement of CEC Director of Finance - Donald McGougan – para 125(3) TRI00000060

3.117 A change in direction with a new Chief Executive in January 2011 and improved controls being put in place during 2011 including the running of project management on Infraco, Utility and CAF elements of the project being transferred to Townsend and Turner appeared, from available evidence in scope to have provided much needed improvement on control. Given the turn of events as highlighted by the evidence in scope it would be our considered opinion that CEC should have considered taking project management responsibilities from Tie at an earlier stage.

3.118 A significant concern was the apparent inability of Tie to share confidential information with its shareholder – CEC due to matters that were considered to be confidential – "as a result of sensitivities around the ongoing dispute negotiations" [68]. Within Audit Scotland's 2011 Interim Report such a position was acknowledged:

"Tie makes regular reports on the projects progress to the Tram Project Board and CEC also provides regular reports to elected members at full Council meetings. The commercially sensitive nature of the dispute with BBS and future financial projections, however, has meant that the information presented to members who are not directly involved in the project has been limited. Given the high profile of the project, the lack of detail which has been made available to some councillors has caused frustrations."[69]

3.119 A key question that supports the first statement in the model is as follows – "Is the Chief Financial Officer a member of the Leadership Team, reporting directly to the Chief Executive and with direct access to the Council and Audit Committee". We understand that the CEC Director of Finance had a continuous presence on the Tram Project Board the management of Tie to his retirement on 30 June 2011. The Director of Finance is the 'proper officer' designated under Section 95 of the Local Government (Scotland) Act 1973. The Edinburgh City Council Financial regulations articulates the role well[70]:

Section 95 states that every local authority shall make arrangements for the proper administration of its financial affairs and shall secure that the proper officer of the authority (termed the Section 95 Officer) has responsibility for the administration of those affairs. The Local Authority Accounts (Scotland) Regulations 1985 further specify that the system of accounting and control and the form of the accounts and supporting records are to be determined by the Section 95 Officer and that s/he is to ensure that accounting controls are observed and the accounts and supporting records are kept up to date. S/he is also responsible for publishing the Annual Accounts of the Council and for making the arrangements for the statutory audit required by s96 of the 1973 Act.

3.120 However we note that upon the retirement of the postholder a restructuring placed his replacement as a third tier post reporting to the Director of Corporate Services.

[68] City of Edinburgh External Auditors Report to Members 2009/10 para 84 ADS00049
[69] Audit Scotland – Edinburgh Trams – Interim Report – February 2011 – Governance arrangements Page 5 ADS00046
[70] Edinburgh City Council – Financial Regulations – para 1.2/1.3 WED00000642

This third tier role as Section 95 Officer and effectively the Chief Financial Officer (CFO) for the Council is not aligned to good practice. Positioning of the CFO at Edinburgh City Council from 2011 does not conform to HM Treasury and CIPFA guidance – reporting through the Director of Corporate services Officer to the Chief Executive – CFO lacks peer status at Corporate Management Team (CMT) level. Good practice[71] recommends that the CFO have equal status to those colleagues on the CMT. It is assumed that the Finance Director at Tie Ltd would have had membership of the Tie Board as an Executive.

3.121 In their report to Members on the 2011/12 Annual Accounts, Audit Scotland highlighted a potential lack of rigour over Tie remuneration arrangements – the appropriateness of loss of office compensation and bonus payments for TIE directors. In terms of internal control we are unsighted on what steps were taken by CEC to validate bonus payments made to Tie Executives or even the assessment of where basic pay should be pitched. We are aware that Tie had a Remuneration Committee which had a hand in agreeing bonus payment levels and note that it was a requirement of the Operating Agreement that the TIE Board required to confirm annually to CEC that "TIE's incentivisation arrangements are aligned to appropriate Project milestones".[72] It was further understood that following concerns being expressed about the payment of bonus for poor performance the CEC Chief Executive was involved in approving a revised remuneration scheme which better aligned achievement of bonus to project results. The critical question that arises outwith the appropriate level of internal control being applied is whether value for money was being obtained from arrangements covering the full timeline of the project. Essentially, was there a clear link between outcomes and the bonus paid? Even outwith acknowledged public sector pay levels we would have expected a tangible link in a way that bonus would only be triggered if pre-set specific outcomes were achieved. Bonus payments within public sector organisations are becoming more common at senior levels although they are regarded as being comparatively modest compared with private sector senior decision makers. We would expect that the transparency around financial reporting in the public sector provides some insight and that bonus would only be predicated by target achievement. A view expressed by the then CEC Director of Finance, which we would not necessarily hold in the context of creating a climate for incentivisation, is that the overall remuneration framework is more relevant than concentration on bonus payments:

"I don't feel that an audit of the bonus arrangements was critical to the project going forward. I would suggest, that the base remuneration for executives was at least as important if not more important than bonus arrangements. Understand that in the private sector bonus arrangements, as long as they are properly constructed and tied to project milestones, would be standard practice and can be helpful in securing successful project delivery. I don't feel that that is a critical lesson learned for future projects. Some people became consumed by the issue of TIE bonuses because they were being paid bonuses for a project that was clearly not being delivered. There are a number of questions that arise out of that. However, I am not sure it was a critical

[71] CIPFA: The Role of the Chief Financial Officer In Public Service Organisations: (Appendix 5)
[72] Operating Agreement between CEC and TIE was entered into on or about 12 May 2008 – Para 2.25 page 8 CEC01315172

issue. In summary, I am suggesting that in the private sector bonuses are standard practice. It doesn't make any sense to me to look at the bonus arrangements and not look at the remuneration in totality. If people are wanting to argue that TIE executives were paid too much then you would need to look at their base salary, their conditions and their bonus arrangements altogether.
There is, however, separately a question about bonus arrangements and whether that meant that TIE executives were incentivised to do things which were not in the interests of the Council. For me that would be a governance issue for TIE. That for me is not a particular criticism of having a bonus scheme itself."[73]

3.122 We understand that Bonus and Termination payments were negotiated on behalf of CEC by the Director of City Development and Tie Executives. We also understand that neither the Director of Finance or the Head of Legal and Administration were involved in this process. In this respect we would be of the view that given termination payments were made in excess of £2m a lack of transparency in this process does not equate to good governance.

3.123 We understand that CEC Audit Committee (replaced by wider remit Governance, Risk & Best Value Committee) was not fully sighted on Tram Performance reports in contravention of agreed governance arrangements[74]. Whilst there was an overlay of forums through individuals being members of the project's main governance body – the Tram Project Board and Tie's own Board with CEC's Directors of City Development and Finance having a number of overlapping roles it is difficult to see why a body crucial to the scrutiny of CEC's internal control framework would be denied access to key performance information. We further understand that as a result of reported weaknesses in scrutiny a Governance and Best Value Committee was established to strengthen the effectiveness of internal controls. The rationale is explained in the following witness evidence extract:

"I would struggle to comment on what oversight and control, if any, did CEC's Audit Committee play in relation to the Tram Project and/or in relation to TIE and TEL. Alan Jackson was the Convener and Donald McGougan was the Executive Director for Finance responsible for audit. What went to the Audit Committee? I just don't know. Certainly after I became Director of Corporate Governance, about October 2011 time, I set up a very different committee i.e. the Governance Risk and Best Value Committee (often known as GRBV). That was a more involved, less reactive committee than the Audit Committee The GRBV had very clear reporting, I think every two months, on progress, costs and timing. I can't say much more than that about the Audit Committee.

The Council had a number of internal control issues, which were all very well documented around that time, not just in relation to the tram project. One of the control issues came out of a relatively weak Audit Committee and arrangements within the Council. They needed to be beefed up severely. They've actually been

[73] Witness Statement of CEC Director of Finance - Donald McGougan – para 259/260 TRI00000060
[74] City of Edinburgh External Auditors Report to Members 2011/12 para 89 ADS00051

praised by Audit Scotland in their more recent reports. GRBV was set up to be a more powerful scrutiny committee than existed previously. As for its exact remit and responsibilities, I can't help you with that but it will be well documented in some Council paper somewhere. The GRBV had a lot more power and ability to scrutinise than the Audit Committee. It was given teeth to actually get into matters. It was created not because of trams. It was created because of a number of issues like trams and controls in the Council. It looked to the tram project every two months for full detail as to costings on the project and an update on the general progress."[75]

Value for Money - PR13, PR15

3.124 PR13 tests the good practice assumption that the organisation systematically pursues opportunities to reduce costs and improve value for money in its operations. This covers both business as usual and investment programme. Statement PR15 looks at the agility and purpose of the active management of Non-Current Assets. Scoring on both statements are extremely low and reflective of the evidence in scope.

Supporting Performance	**PR13**	The organisation systematically pursues opportunities to reduce costs and improve value for money in its operations.	**1.0**
	PR15	The organisation pursues value for money through active management of its Non-Current assets.	**0.5**

3.125 The first statement considers the systematic delivery of value for money in ordinary activities, the FM Model envisages a detailed plan of specific Value for Money improvements either as a separate plan or as an identified element of the budget.

3.126 The developing approach for delivering Value for Money throughout the project was not articulated in a coherent detailed strategy document or indeed across the evidence in scope. Whilst targets were set by Tie Ltd in the period to 2011 we did not see any systematic approach which would provide CEC/Tie staff with the necessary robust framework for actively driving, managing and monitoring Value for Money and outcomes. We could see that specific components of the projects has specific targets but we were unsighted on the detail behind such targets. There appeared to be a renewed emphasis on cost control and value for money from the appointment of Turner & Townsend to replace Tie Ltd in the substantive management of the Tram project from 2011. A key supporting question tests the extent that Managers examine cost drivers of high-spend areas to understand risks and options for cost reduction. Whilst there was evidence that attempts were made to do just that, contractual issues and lack of certainty around cost control and agreed Consortium billing effectively mitigated against a consistency in approach. Compounding such

[75] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance – Alistair McLean – Paras 183 TRI00000055

issues were matters of accountability. For example weaknesses in accountability for the cost-effectiveness of decision making and insufficient depth in "holding to account" for financial performance.

3.127 We have no doubt that project 'lock in' was a feature that mitigated against the optimal achievement of VFM - value for money – economy, efficiency and effectiveness – especially in the period to 2011. Significant weaknesses in the construction of the contract no doubt significantly impaired any ability to apply rigour in the application of VfM. In this context the following quote provides a salient backdrop to the position staff at Tie and CEC found themselves in:

"The obvious problem was that the design wasn't complete before the contract was let. People didn't really know what they were buying."[76]

3.128 Overall the evidence in scope points to VfM being a secondary consideration with project delivery having primacy. Concentration was unduly placed upon Benefits Realisation rather than achieving full VfM. This is articulated in selected witness statement quotes:

"*However, overall, the project in BCR terms would not be regarded as value for money.*[77]"

"*In summary, CEC were saying that we could fund £600m at that stage but to go beyond that we might need some form of assistance or some further funding mechanism approval. By this time value for money wasn't the primary issue. The issue was to get the project completed at an affordable price that would give us an asset capable of generating revenue in future years.*[78]"

"*I note the record of the Quarterly Review with Transport Scotland dated 24 September 2010 (TRS00011378). It notes that "the Council confirmed that they would find it very difficult to recommend any VFM [presumably, value for money] decision to agree a £600m option to St Andrew Square/York Place". There is a difference between value for money and affordability. I think, this was more about afford ability than value for money*.[79]"

3.129 Within the available evidence provided we had some difficulty in positioning Tie's annual operating costs within overall project management costs e.g. significant pension cost exposure and lack of scrutiny around staffing structures and consequential costs. A basic analysis of staff costs from Tie's accounts reveals the following pattern of payroll related expenditure from 2007 to 2013:

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[76] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance – Alistair McLean – Paras 139 TRI00000055

[77] Witness Statement of CEC Director of Finance – Donald McGougan – para 301 TRI00000060

[78] Witness Statement of CEC Director of Finance – Donald McGougan – para 244 TRI00000060

[79] Witness Statement of CEC Director of Finance - Donald McGougan – para 244 TRI00000060

Category	2007	2008	2009	2010	2011	2012	2013
Salaries & Wages	£2,909,052	£5,044,720	£4,479,965	£4,661,739	£4,335,039	£1,942,567	-£544
Social Security Costs	£285,477	£520,988	£534,627	£405,697	£406,738	£349,195	£197
Other Pension Cost	£287,837	£389,757	£391,081	£334,041	-£193,246	£559,436	£1,831
Other Staff Costs	£74,639	£13,990					
Termination Payments					£0	£2,008,126	
Totals	£3,557,005	£5,969,455	£5,405,673	£5,401,477	£4,548,531	£4,859,324	£1,484
Employees - average	55	80	84	86	77	39	0
Average Payroll Costs	£64,673	£74,618	£64,353	£62,808	£59,072	£124,598	£0

3.130 Accounts for Tie Ltd conform to relevant accounting disclosure rules. Bonus or incentivisation arrangements cannot be identified from the notes to the accounts. Our evidence suggests that Tie Ltd were given significant latitude in the formulation of its staffing structure.

3.131 We understand that concerns emerged around bonus arrangements for Tie executives. There was some inference that certain controls within the Operating Agreement between Tie and CEC had been "watered down at TIE's insistence / on the instruction of senior executives in the Council".[80] Bonus payments were apparently made on termination of senior Tie Executives. We are assuming that such payments were within the £2,008,126 sum made in 2012. We understand that bonus payments may have been rolled up within final salary termination payments. In such circumstances we are unsighted as to whether bonus and final payments were made in relation to the achievement of actual performance targets and value for money was fully secured.

3.132 Overall we did not detect any rigour or challenge applied by CEC over Tie's annual operating costs within overall project management costs – "*Revenue expenditure on TIE is zero. That is because all TIE costs were already re-charged to the tram project and classified as capital.*"[81]

3.133 The fact that all of Tie's operating costs were capitalised and met from grant funding and long term borrowing through the Prudential Borrowing Framework may not provide the same incentivisation for challenge and scrutiny as a project met by General Fund revenue sources. This has been the case in some local authorities we have worked with where significant fiscal retrenchment brought about by grant funding reductions and political restrictions on Council tax rises has created an unequal application of VfM rigour on monitoring between Capital and Revenue programmes. Capital Programme financed by long term borrowing being given a 'lighter touch' approach than annual revenue spend and income activity. We note that within Tie's 2010/11 Accounts the crystallisation of a £4.632m pension deficit in respect of Tie employees:

[80] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance - Alistair McLean – Paras 186 TRI00000055

[81] Witness Statement of CEC Director of Finance - Donald McGougan – para 319 TRI00000060

"… any such sum should have been charged to the project once it had actually materialised. Clearly this would not have been anticipated in the 2007 Business Case."[82]

3.134 A key supporting question for this statement tests the extent that comparative analysis is undertaken – national/local performance measures – operational/financial. We understand that significant relevant research work was undertaken within the Procurement Phase of the project running from 2001 to May 2008. Relevant transport infrastructure projects in scope included the Lewisham extension to the Docklands Light Railway (DLR) in London and the Manchester Metrolink. We understand that Tie was influenced by the National Audit Office (NAO) on the separation of construction and operating functions in terms of minimising the overall risks of having undue reliance on the constructors to operate the light railway.[83] However, we are unsighted on any comparative analysis undertaken on on-going project management of transport infrastructure projects and any lessons learned that could have or were incorporated within the actual management of the Tram Project. In short there is a lack of visibility on comparative analytics of other tram project capital and running costs that may have assisted.

3.135 Overall the available evidence does not indicate that a VfM approach was fully embedded within the management of the project in a way set out within statement PR13. Indeed the good practice approach of systematically pursing opportunities to reduce costs and improve value for money seems to have been relegated behind delivery/progression.

3.136 Comments on PR15 associated with a lack of active asset register detail are primarily dealt with under our Asset Management heading. In essence the absence of an asset register and specific asset management plan would make it extremely difficult for any organisation to actively review and optimise asset utilisation and our scoring is reflective of that position.

External Financial Reporting – PR7

3.137 Statement PR7 seeks to test how the organisation's financial accounting and reporting meet professional and regulatory standards. A primary issue for consideration in the context of the project would be the degree to which project costs would be accurately recorded and properly reported within the accounts of both Tie and CEC. Relevant supporting questions associated to this good practice statement would include the following:

- Did the accounts achieve financial balance and other statutory financial obligations?
- Were statutory requirements, accounting policies, professional guidance and standards followed?

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[82] Witness Statement of CEC Director of Finance - Donald McGougan – para 322 TRI00000060
[83] Audit Scotland – Edinburgh Trams – Interim Report – Page 12 ADS000046

- Are complex accounting issues (e.g. Private Finance Initiative (PFI), International Financial Reporting Standards (IFRS)) identified promptly and resolved within the necessary timescale?
- Do staff follow guidance on final accounts closedown procedures, including timetables?
- Was an unqualified audit opinion given?

3.138 Statement PR7 scoring achieved 2.0 from 4.0:

Securing Stewardship	**PR7**	The organisation's financial accounting and reporting meet professional and regulatory standards.	**2.0**

3.139 We understand that the final cost of the Trams Project has been assessed at £776.481m. This has been broken down into the following cost categories[84]:

[84] "Edinburgh Tram Project: Cost of Work completed to Date" CEC02085665

Edinburgh Tram Project Cost of Work completed to Date	2003 - 2017
Cost Categories	**£'000**
Comms and Stakeholder - external comms and media	£2,724
Comms and Stakeholder	£837
Design	£26,690
Infraco	£425,485
Land, property and other costs	£31,255
Legal DLA	£3,503
Legal Other	£3,011
Legal - post mediation	£2,271
Off-street infrastructure - other	£19,819
On-street infrastructure - other	£1,439
PM - Management and supervision	£70,115
PM - Accommodation and Support Costs	£14,463
PM - Insurance	£6,060
Ready for Ops - Transdev and Edinburgh Trams Staff	£10,066
Ready for Ops - LB recharges and other costs	£3,097
Ready for Ops - Ticket Machines	£997
Ready for Ops - Others	£560
Utilities - MUDFA	£57,252
Utilities - post settlement agreement	£21,229
Utilities - other	£25,675
Vehicles - construction/fabrication	£23,448
Vehicles - delivery of trams	£4,513
Vehicles - manuals, special tools and spare parts	£4,954
Vehicles - other	£28,676
Vehicles - vehicle design	£2,752
Less: Funding contributions	-£14,408
TOTAL	**£776,481**

3.140 All of the Tram Assets should be held within the Balance Sheet of CEC – from this basic assumption we should be able to make a determination of overall capital cost of the project. The determination of total project expenditure should be readily achievable or at least total Capital Expenditure for which assets have been recognised on CEC's balance sheet. Flowing from this we can make assumptions about how such overall capital expenditure was financed. Within our analysis of the CEC Balance Sheet we observed that there is no separate or specific classification for 'trams' – or Tram Assets. We would anticipate that the bulk of the tram network assets are included in 'infrastructure' (which also includes Edinburgh City Council's road network). There may also be tram assets/spend included in other categories (e.g. other land & buildings; vehicles, plant, furniture & equipment; assets under construction).

3.141 It is therefore not possible to categorically reconcile or identify the spend added to the balance sheet for each year in respect of tram related assets without the specific additional information provided in note format. An extract from CEC's 2014/15 accounts illustrates the lack of tracked classification of Tram Assets – which we believe are within the £912.496m of Infrastructure Assets as at 31 March 2015:

14. Property, Plant and Equipment - continued
14.3 Movements on Balances - Group Accounts
Movements in 2014/15

	Council Dwellings £000	Other Land and Buildings £000	Vehicles, Plant, Furniture and Equipment £000	Infrastructure Assets £000
Cost or Valuation				
At 1 April 2014	1,017,560	1,854,171	215,260	1,316,428
Additions	33,769	31,861	29,195	34,332
Revaluation increases / (decreases) recognised in the Revaluation Reserve	3,299	(16,956)	3,725	0
Revaluation increases / (decreases) recognised in the Surplus on the Provision of Services	48	(16,657)	0	0
Derecognition - disposals	(7,525)	(5,241)	(2,878)	0
Derecognition - other	0	0	(8,632)	0
Assets reclassified (to) / from held for sale	0	(5,816)	0	0
Other movements in cost or valuation	0	155	63,949	0
At 31 March 2015	1,047,151	1,841,517	300,619	1,350,760
Accumulated Depreciation and Impairment				
At 1 April 2014	(209)	(90,478)	(111,883)	(375,081)
Depreciation charge	(17,746)	(47,658)	(17,731)	(63,183)
Depreciation charge written out to Revaluation Reserve	231	20,671	0	0
Depreciation written out to the Surplus on the Provision of Services	4	5,830	0	0
Derecognition - disposals	127	2,181	2,593	0
Derecognition - other	0	0	5,793	0
Impairment losses recognised in the Surplus on the Provision of Services	0	0	(1,264)	0
Other movements in cost or valuation	0	54	0	0
At 31 March 2015	(17,593)	(109,400)	(122,492)	(438,264)
Net book value				
At 31 March 2015	1,029,558	1,732,117	178,127	912,496
At 31 March 2014	1,017,351	1,763,693	103,377	941,347

3.142 In tracing annual expenditure we were able to secure the following breakdown of Tram Project Expenditure – an extract is illustrated below:

The City of Edinburgh Council - Tram Related Assets reflected on CEC Balance Sheet

	Vehicles, Plant and Equipment	Infrastructure	Total
2004-05	0	5,421,971	5,421,971
2005-06	0	16,077,561	16,077,561
2006-07	0	33,939,434	33,939,434
2007-08	0	81,774,047	81,774,047
2008-09	15,144,577	69,224,056	84,368,633
2009-10	26,585,948	93,308,167	119,894,115
2010-11	5,593,803	122,342,380	127,936,183
2011-12	9,681,198	99,862,658	109,543,856
2012-13	4,577,838	130,537,457	135,115,295
2013-14	1,830,891	51,367,547	53,198,438
2014-15	534,819	4,711,617	5,246,436
2015-16	0	1,596,381	1,596,381
	63,949,074	710,163,275	774,112,349
Revaluation of Vehicles, Plant and Equipment on becoming operational	3,724,604		3,724,604
Gross Book Value in Asset Register	67,673,678	710,163,275	777,836,953

3.143 It is clear that significant expenditure was incurred up to Financial Close in May 2008. The £777.837m does not equate exactly with the final reported expenditure position of £776.481m. This financial reporting position together with the absence of an Asset Register – which we consider to be fundamental to sound asset management – does not provide the level of assurance we would expect to provide the detail on the overall project spend of £776.481m. However whilst the CIPFA FM Model is looking for the existence of processes that ensuring that Assets and Liabilities are recorded accurately in the Balance Sheet a key line of assurance here comes from the opinion of the external auditors, which concluded that the Council's accounts presented a true and fair view for each year within scope.

3.144 In terms of establishing overall costs we would expect that proper accounting treatment to be applied in the allocation of CEC service management costs. Whilst input may vary over the project life we would expect a consistent approach to the allocation of CEC staff and related overhead costs. However, witness evidence indicates that overall costs may not have included appropriate levels of CEC activity:

"Broadly, within CEC directors were given a fixed budget to spend in order to provide the services that they had to provide. Occasionally, certain projects or certain departments incurred a cost, usually staffing, that they charged back to the internal client department. So it was an internal charging system. That's why it was nicknamed recharging. By and large the costs of the CEC officers working on the tram project weren't included in the total cost of the tram project reported to members. ***With the exception of internal legal costs and maybe a few other minimal***

exceptions, internal staff costs of the Council were not recharged or included in the overall costs."[85]

3.145 We also understand that within the financial year 2010/11 approximately £2.3m of legal costs associated with mediation and dispute resolution were charged to revenue and may not be fully reflected within overall project costs as some £6.7m in respect of delays and design faults.

3.146 Within our comments on Asset Management (PR10) we highlighted that we were advised that 10 Tram Units were surplus to requirements. However the costs of the full 27 tram units appears to be capitalised which includes the 10 unit surplus to requirements as a result of the decision to reduce the scope of routing to St Andrews Square. If such units do not have an alternative use and are unable to be readily disposed of we would expect some additional impairment charges to be applied. From the Annual Accounts and Balance Sheet it is unclear if this has been applied. Indeed the absence of an Asset Register and associated management information makes it difficult to assess how Tram Assets are being utilised and managed.

3.147 More assurance is required over accounting treatment on the capitalisation (and impairment) of some £59.9m of historical claims[86] including some aborted costs associated with Phase 1b and assets beyond St Andrew Square. This issue was raised by Audit Scotland in the Report to Members on the 2011/11 Accounts and is obviously material. However is unclear how such costs were treated within the Accounts and what level of impairment was applied – in full or over subsequent years for such assets.

3.148 Unless granted a notable exemption by HMRC we have assumed that the bulk of the £776.481m of Tram related expenditure (excluding Staffing and other exempt and zero rated costs) will have been subject to standard VAT as most of the incurred costs would have been determined as a vatable supply. If so we would expect VAT to be a significant element of cost. For example stage payments to Infraco would have VAT applied. We understand that the overall project costs of some £776.481 million are net of any VAT liability.

3.149 The accounts of Tie Ltd record significant expenditure which was obviously related to core project expenditure although the creation of assets fall upon the balance sheet of CEC although some vatable supplies would be incurred by Tie Ltd. Within witness statement evidence the CEC Director of Finance explains the relationship between CEC and Tie on cost transfers as follows:

"I have been asked to outline how income and expenditure related to the Tram project and TIE are in included in the Council accounts for 2008/09. Income and expenditure for the Tram Project and TIE are in various sections of the account for 2008/09. Costs of the project up to 31 March 2009 were charged to the capital

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[85] Witness Statement of the CEC Head of Legal and Administration/Director of Corporate Governance – Alistair McLean – Para 172 TRI00000055

[86] City of Edinburgh External Auditors Report to Members 2010/11 para 38 ADS00050

expenditure account and offset by capital income from Government grant. Revenue expenditure on TIE is zero. That is because all TIE costs were already re-charged to the tram project and classified as capital."[87]

3.150 Tram assets have been recorded on the balance sheet of CEC and we assume that recoveries on Net Input Vat would have been initiated through CEC. Local authorities can recover net input VAT on vatable supplies as a consequence of Section 33 of VAT Act 1994. This allows certain bodies such as local authorities to recover VAT on costs relating to non-business activity. Tie Ltd would not normally be considered by HMRC to be a 'section 33' body so if the contract, procurement and billing was aligned to Tie with the vatable supply incurred by Tie, recover of VAT on costs would not be possible unless there were business sales/outputs that rendered a consequential vatable supply. In such circumstances it would be difficult to see how CEC could recover net input VAT on tram project expenditure. If there was no recovery made by CEC the overall costs including VAT would have come within the quantum funded by grant and borrowing for overall project expenditure. Had Tie not existed and CEC ran the project 'in house', such costs met from grant funding and borrowing would have excluded VAT as the authority would have been permitted to recover net VAT. However, we were advised that all Tram Project costs recorded within the CEC balance sheet exclude VAT. From this we would normally assume that VAT recoveries were made by CEC. If Tie was the recipient of the vatable supply it is difficult to determine how such a position could actually work in practice.

Asset Management - PR10, PR15

3.151 Good practice requires that an organisation maintains processes to ensure that information about key assets and liabilities in its balance sheet is a sound and current platform for management action (statement PR10). Good practice also requires that organisation pursues value for money through active management of its Non-Current assets (statement PR15).

Securing Stewardship	**PR10**	The organisation maintains processes to ensured that information about key assets and liabilities in its balance sheet is a sound and current platform for management action.	**0.5**
Supporting Performance	**PR15**	The organisation pursues value for money through active management of its Non-Current assets.	**0.5**

3.152 In respect of PR10 the primary supporting question tests the extent to which Asset Registers are maintained and updated on a regular basis. Asset registers are critical to the effective asset management as well as informing financial reporting including balance sheet management. It is our understanding that CEC/Tie do not have asset

[87] Witness Statement of CEC Director of Finance - Donald McGougan – para 301 TRI00000060

registers for the Tram Assets. In our view this would make it difficult for CEC to properly assess and manage assets without an Asset Register.

3.153 Key financial reporting information is typically derived from an asset register. The tracking of capital expenditure, disposals, depreciation and impairment are all key features of what we would expect should be sourced from a properly constituted asset register. All of the Tram Assets should be held within the Balance Sheet of CEC. Each year, for financial reporting purposes the balance sheet will be adjusted for:

- New Assets acquired and in use
- Depreciation
- Impairment/valuation changes
- Assets under construction

3.154 Good practice requires this information being collated within an asset register which should mirror the asset values within CEC's accounts – moreover this data should effectively create the figures contained within the accounts as the Asset Register should the primary source of any base figures that are used within financial reporting and asset value changes transparently tracked to CEC's balance sheet .Without such information it is difficult to assess whether both key financial reporting obligations and on-going asset management decision making is effective.

3.155 The Model considers good practice to be reporting the complete balance sheet on at least a quarterly basis to Members/Corporate Management Team, highlighting exceptional or unusual impacts. We are not aware of any evidence that substantiate this position.

3.156 A key supporting question for PR15 tests the extent that the organisation has an asset management plan that reviews the condition, sufficiency and suitability of assets in the light of business needs and the ambitions of the Corporate Business Plan. Whilst there will be aspects of this in place – the Audit Scotland – Audit of Best Value and Community Planning – May 2013 concluded that "*the Council had good arrangements for property rationalisation and improvement and aims to make further savings from better management and use of assets* "[88], it is not clear whether Tram Assets are subject to a detailed Asset Management strategy. We noted that 27 Tram units were procured and received when only 17 units were required for the revised Phase 1a routing. We also noted that attempts had been made to sell surplus units. However we are unsighted as to how these additional units have been managed. We believe that an Asset Register is fundamental to good practice in the management of assets. In this context it is difficult to see how CEC is optimising Tram Assets in terms of value for money.

[88] Audit Scotland – City of Edinburgh Council Audit of Best Value and Community Planning – May 2013 – Para 113 ADS00045

Financial skills – P1

Securing Stewardship	**P1**	The organisation identifies its need for financial competencies and puts arrangements in place to meet them.	**1.5**

3.157 This statement deals primarily with the general need that organisations require financial skills at all levels. Many public bodies now formalise this need through a competency framework, defining the integrated knowledge, skills, judgment, and attributes that individuals need to perform a job effectively. Across UK Central Government there is a Civil Service Competency Framework that sets out core competencies needed, including those covering elements of Financial management under the broad headings of 'achieving commercial outcomes', 'delivering value for money, and 'managing a quality service'. Many UK Local Authorities have a similar framework. A competency framework typically deals with the competencies required at three levels within the organisation and identifies effective and ineffective behaviours as indicators.

3.158 The UK Government Finance Profession (GFP) has a set of defined gateway and professional expertise review requirements for finance professionals in government at three key career levels (Grade 7, SCS PB1 and SCS PB3 level). The GFP has also defined broader experience requirements for PB1 level. This framework is to be used (advisory) by government departments for recruitment, performance management and development discussion and for decisions about progression.

3.159 Critical to the success of any project is the degree to which those responsible for resource management decisions possess appropriate skills and expertise. One of the main drivers behind the creation of the arms-length company (Tie Ltd) was the requirement to obtain the best staff possessing appropriate project management, commercial and financial management skills commensurate with the project in hand:

"More generally the wholly owned local authority companies were capable of providing a greater focus on limited and specific specialist areas. They were able to have commercial freedom in relation to the recruitment and retention of staff where the Council might have had issues because of market rates and scarce resources."[89]

3.160 We would expect that CEC should have had processes in place to ensure that for the recruitment of employees associated with Tie Ltd appropriate steps were taken to identify a minimum level of skills/experience for each post and that steps are taken to verify such requirements in those potential employees that are selected. In terms of performance management we would also expect that any gaps would be identified and corrective action taken. In organisations we have looked at across UK and beyond, competency frameworks have been an important driver in raising the profile of requirements and establishing that financial management skills are part of the core requirements for non-finance posts. Indeed, such core skills are essential if

[89] Witness Statement of CEC Director of Finance - Donald McGougan – para 341 TRI00000060

decision makers are to appropriately fulfil their accountability responsibilities. Without a competency framework being applied it is difficult to identify skill gaps and training needs.

3.161 We could find little evidence to confirm that a demonstration of financial management competencies was a fundamental requirement in the recruitment, selection and promotion processes for non-finance staff expected to have financial management decision making capability for all those involved in the management of the Tram Project. Notwithstanding appropriate financial management skills we would have expected evidence of required skill sets including a strong focus on the following:

- Negotiation
- Commercial Contract Construction
- Project Management

3.162 Witness statement evidence suggests that financial management expertise of senior staff members employed by Tie was assumed. However, we were unsighted on the recruitment requirements[90]:

"TIE was costing the Council £6m I£7m a year. In size it was a substantial organisation, with individuals skilled in project management, engineering, finance and so on. Almost all of them had significant private sector and commercial experience."

"… the Council wanted people in TIE with "hardnosed" commercial experience. Those senior, private sector individuals were intended to be better placed to respond to that pressure than perhaps Council officials would have been. David Mackay was very experienced as a former Chief Executive of the John Menzies Group. Brian Cox was a former Executive Director of Stagecoach. I think Graeme Bisset was formerly Kwik¬Fit's Director of Finance and is now the Chairman of the Macfarlane Packaging Group. These were all people of substance, specifically brought into the project to provide high level commercial expertise. They were the ones negotiating across the table with their German counterparts."[91]

3.163 We understand that a 2005 agreement between CEC and Tie Ltd provided for the Council [92] to appoint non-executive directors to the Board of Tie with a proven track record:

Council will use its reasonable endeavours to appoint up to four non-executive directors from outwith the Council with a proven track record in business, finance and or transport, who bring valuable expertise to the Board of Directors. These would be annual appointments made by the Council. The Council may re-appoint any director. Fourth (5)

[90] Witness Statement of CEC Chief Executive - Tom Aitchison – para 175 TRI00000022
[91] Witness Statement of CEC Chief executive - Tom Aitchison – para 166 TRI00000022
[92] Agreement between City of Edinburgh Council with Transport Imitative Edinburgh (TIE) Limited – of the second part 2005 – (5) - CEC00478603_0004

3.164 We have no doubt that some staff should have been able to provide appropriate evidence of relevant financial management skills – for example Graeme Bisset is an acknowledged leader in corporate finance. However, given the lack of tangible evidence particularly across the executive team there is some uncertainty as to whether such skills were tested within the recruitment process for Tie staff. For those CEC staff advising this is also a relevant issue and would have included demonstrating adequate skills and experience of complex infrastructure project work. It is also unclear whether elected CEC or Tie Board Members had appropriate training on financial scrutiny and decision making.

3.165 We understand that pay structures were designed to acquire such experience:

"The Report to Council dated 26 June 2003 (CEC02083550) noted that a performance related bonus scheme had been introduced for TIE staff. The scheme was primarily a matter for the Remuneration Committee and the Board of TIE. From the Council's viewpoint, it was created because of commercial considerations, linked to the ability to recruit / retain staff with key skills / abilities and allow incentivisation of performance. I don't think the bonus scheme applied to staff seconded from the Council."[93]

I understood the requirement for bonus schemes was to take into account recruitment, retention and incentivisation issues. TIE were competing with the private sector for people with particular skill sets and so they had to likewise offer packages which included an incentivisation of performance element.[94]

3.166 As there was no evidence on the application of a financial competency framework we are unsighted on any attempt to assess competency levels through a training needs analysis and devise a programme to upskill staff. Typically good practice performance appraisal processes should include provision to identify skill gaps. However, we were unaware of any formal appraisal processes used to track employee performance. We would assume that the remuneration framework at Tie Ltd would have required a formal appraisal process to be engaged in order to assess bonus entitlement. Whilst we are aware that bonuses were paid we are unsighted on the performance assessment arrangements which would have triggered payments. Indeed, given the challenges and actual performance in achieving overall project objectives it is difficult to foresee what good performance would 'look like' and how good performance could be translated into personal objectives of Tie staff. Indeed, the same could be said of CEC staff. In such a context there is a lack of evidence to show that Tie/CEC staff were being consistently appraised on financial performance.

[93] Witness Statement of CEC Director of Finance - Donald McGougan – para 345 TRI00000060
[94] Witness Statement of CEC Director of Finance - Donald McGougan – para 348 TRI00000060

4. Governance

4.1 CIPFA exists to promote excellence in financial management, governance and performance in entities that provide public services. CIPFA sets standards for financial reporting in a large part of the public sector (namely local government) and is a standard setter for governance of entities that work in and with the public sector. This section of our report will look at prevailing standards of governance as applied within the arrangements covering the Tram project.

4.2 Standards of good corporate governance have essentially evolved from challenges faced by the private sector. Due to a number of high profile irregularities on financial reporting (Mirror Group Newspapers/Maxwell, Polly Peck etc.) a committee was set up to look at the Financial Aspects of Corporate Governance Committee. This was chaired by Sir Adrian Cadbury. The 'Cadbury Report' as it was known was published in 1992 and made a number of wide ranging recommendations on good corporate governance including the transparency of financial reporting and the need for robust internal controls. A number of initiatives followed including the Greenbury Report on remuneration disclosure and governance. In 1996, the Hampel Committee was created to examine the impact of both reports and the primary outcome was a Combined Code of Corporate Governance published in 1998 drawing on both sources. Building upon the combined code the Turnbull Committee published recommendations on strengthening internal controls.

4.3 In terms of public sector application of this move to improved corporate governance, in 2004 CIPFA and the Office for Public Management established an Independent Commission on Good Governance in Public Services under the Chairmanship of Sir Alan Langlands. The role of the Commission was to develop a common code and a common set of principles for good governance across the public services. In January 2005, the Commission published its Good Governance Standard for Public Services which builds on the Nolan Principles by setting out six core principles of good governance for public bodies.

4.4 In July 2014, CIPFA and the International Federation of Accountants (IFAC) published its 'International Framework – Good Governance in the Public Sector' that provides an overarching set of seven principles which national codes and sectors can reference when reviewing or introducing governance standards and guidance. In this guidance, the fundamental function of good governance in the public sector is to ensure that 'entities achieve their intended outcomes while acting in the public interest at all times'. Using this Framework, CIPFA developed an accreditation scheme that assesses governance against the seven core principles and can award its 'Mark of Excellence' to those that demonstrate excellence in all of the seven assessment areas.

4.5 This framework was developed on prevailing good practice introduced by the Independent Commission on Good Governance in Public Services highlighted in paragraph 4.3 above. This guidance was published as the Good Governance Standard for Public Services and its aim and scope was to assist"… *with the governance of* *public services not only to understand and apply common principles of good governance, but also to assess the strengths and weaknesses of current governance practice and improve it"*[95]. The application was intended to cut across the spectrum of legal formations – public and private sectors organisation with the common connection and objectives:

"The Good Governance Standard for Public Services is intended for use by all organisations and partnerships that work for the public, using public money. Most of these are public sector organisations whose services are used directly by members of the public or who are responsible for less visible activities, such as regulation and policy development. However, the use of public money to provide public services is not limited to the public sector. The public also has an interest in the governance of non-public sector organisations that spend public money, and the Standard is designed to help them too."[96]

Principles of good governance

4.6 The standard published in January 2005 comprised six core principles of good governance each with its supporting questions. Appendix 6 outlines the prevailing 2005 guidance and Appendix 7 highlights the CIPFA/SOLACE framework for Local Government application based on this initial work. The aim of the Commission was for the standard to be applied to assess the degree to which organisations deliver to the Standard with action planning providing any necessary improvements to bridge any assessed gap. The six core principles are as follows:

1. **Good governance means focusing on the organisation's purpose and on outcomes for citizens and service users**
   - 1.1 Being clear about the organisation's purpose and its intended outcomes for citizens and service users
   - 1.2 Making sure that users receive a high quality service
   - 1.3 Making sure that taxpayers receive value for money
2. **Good governance means performing effectively in clearly defined functions and roles**
   - 2.1 Being clear about the functions of the governing body
   - 2.2 Being clear about the responsibilities of non-executives and the executive, and making sure that those responsibilities are carried out
   - 2.3 Being clear about relationships between governors and the public
3. **Good governance means promoting values for the whole organisation and demonstrating the values of good governance through behaviour**
   - 3.1 Putting organisational values into practice
   - 3.2 Individual governors behaving in ways that uphold and exemplify effective governance
4. **Good governance means taking informed, transparent decisions and managing risk**

[95] The Good Governance Standard for Public Services – Page 8 (Appendix 6)
[96] The Good Governance Standard for Public Services – Page 8 (Appendix 6)

4.1 Being rigorous and transparent about how decisions are taken
4.2 Having and using good quality information, advice and support
4.3 Making sure that an effective risk management system is in operation

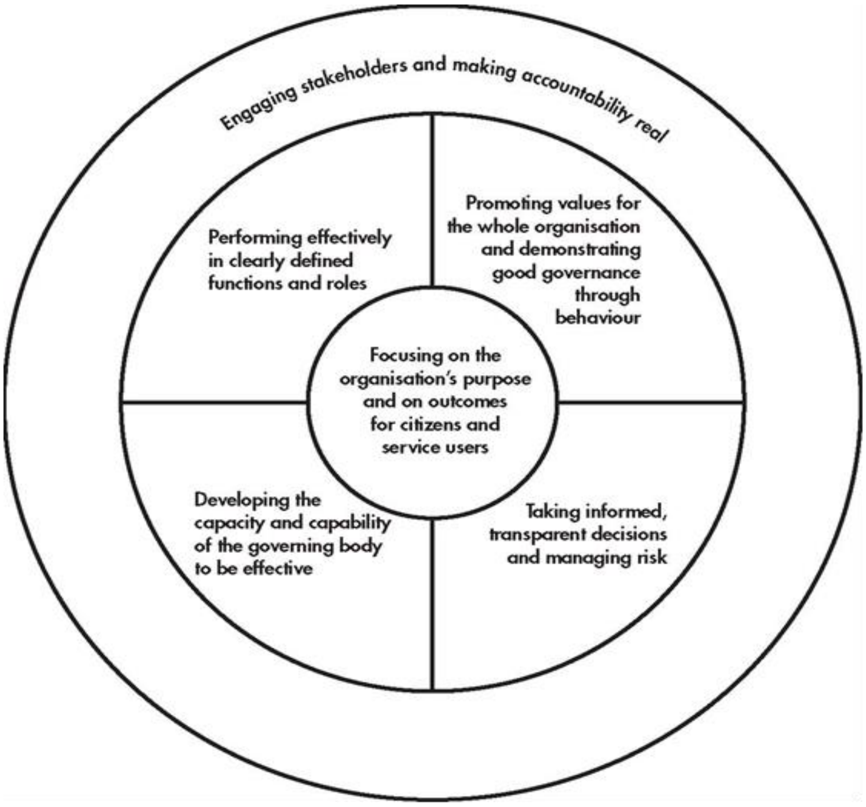
5. **Good governance means developing the capacity and capability of the governing body to be effective**

5.1 Making sure that appointed and elected governors have the skills, knowledge and experience they need to perform well
5.2 Developing the capability of people with governance responsibilities and evaluating their performance, as individuals and as a group
5.3 Striking a balance, in the membership of the governing body, between continuity and renewal

6. **Good governance means engaging stakeholders and making accountability real**

6.1 Understanding formal and informal accountability relationships
6.2 Taking an active and planned approach to dialogue with and accountability to the public
6.3 Taking an active and planned approach to responsibility to staff
6.4 Engaging effectively with institutional stakeholders

4.7 Diagrammatically this can be represented as follows:



4.8 Aspects relating to each of the core principles can be found within our findings assessing the available evidence in scope against the CIPFA Financial Management Model. However what is different is the change of emphasis towards the integrity of wider management processes.

4.9 We have allocated specific issues arising from our review against the six core principles as follows:

1. **Good governance means focusing on the organisation's purpose and on outcomes for citizens and service users**

1.1 Being clear about the organisation's purpose and its intended outcomes for citizens and service users

1.2 Making sure that users receive a high quality service

1.3 Making sure that taxpayers receive value for money

4.10 Relevant issues arising include the following:

- Losing project focus - changing strategy and significantly reduced final output
- Lack of full alignment between Tie and CEC to 2011
- Lack of embedded VfM

2. **Good governance means performing effectively in clearly defined functions and roles**

2.1 Being clear about the functions of the governing body

2.2 Being clear about the responsibilities of non-executives and the executive, and making sure that those responsibilities are carried out

2.3 Being clear about relationships between governors and the public

4.11 In June 2006 CEC required that the major shareholding companies under group arrangements adopt an updated Code of Guidance for corporate governance[97]. The previous year CEC had put in place a framework in place through formal agreements between the Council and Tie Ltd that required Tie to deliver best value in the use of resources and adhere to good corporate governance and council guidance:

"To ensure best value in the provision of services to the Council, act commercially; to act in the Council's best interests at all times; in relation to Council sponsored projects the Company shall liaise solely in the first instance with the Council regarding the resolution of strategic or business planning issues; to work with the Council to ensure that all of the statutory requirements on the Council in respect of Council sponsored projects are met to apply principles of good corporate governance; to co-operate with and implement any recommendations made to the Council by its external auditors concerning the performance of this Agreement by the Company; and to co-operate with any monitoring operation carried out by or on behalf of the Council …"[98]

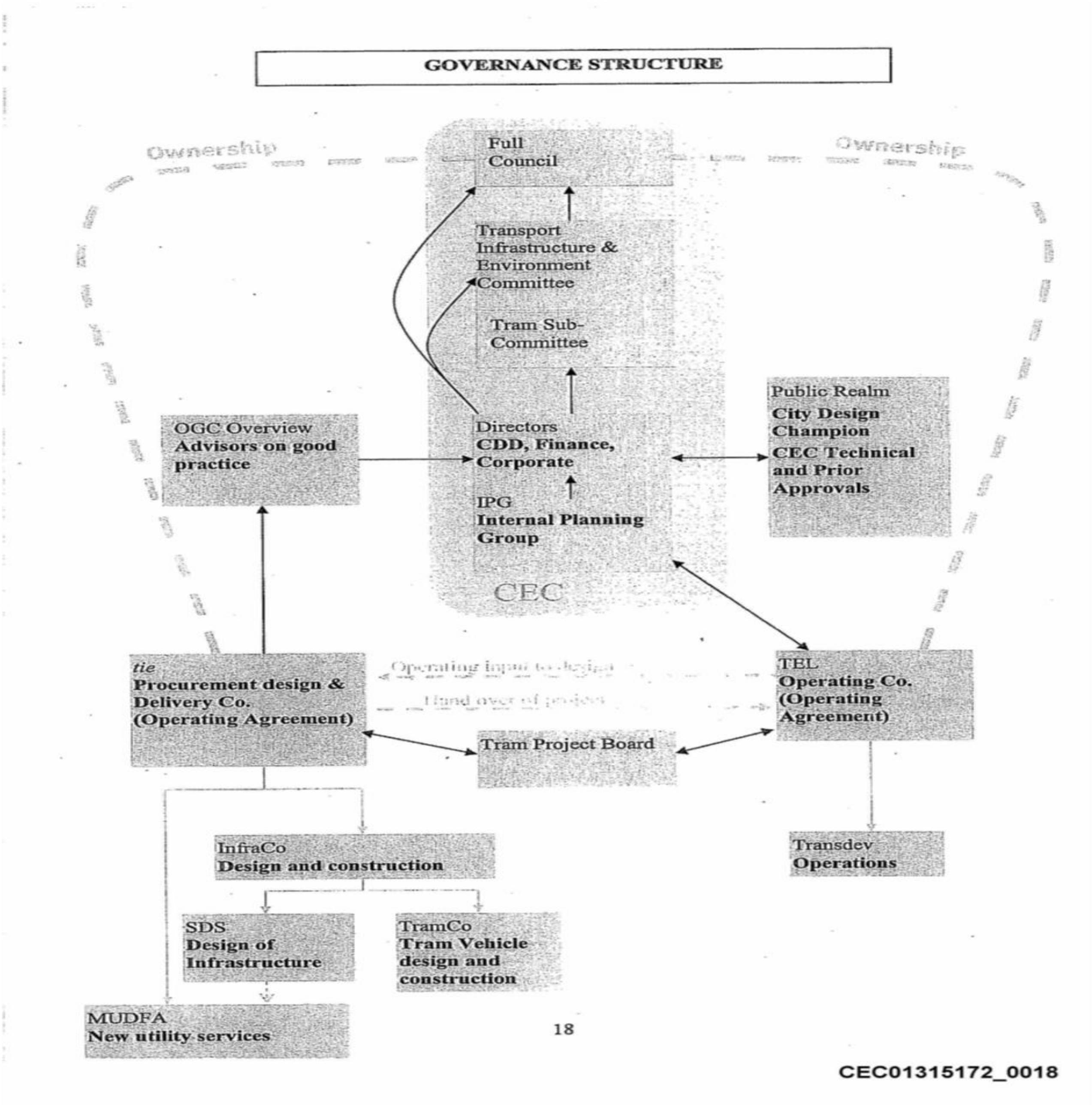
4.12 This was further included in a subsequent 2008 agreement:

[97] City of Edinburgh Council – Council Companies –Code of Guidance June 2006 CEC02084254

[98] Agreement between City of Edinburgh Council with Transport Initiatives Edinburgh (TIE) Limited – of the second part 2005 - Third – Company's obligations (3) - CEC00478603_0004

"2.16 Tie shall use best endeavours to ensure best value when providing the Services in the discharge of all of tie's responsibilities. Tie shall use best endeavours to ensure best value in the use of funds or resources through or by the Council,
2.17 Tie shall continue to apply principles of good corporate governance and adopt and adhere to the Council's Code on Corporate Governance (approved by the Council on 29 June 2006) as it may be amended from time to time."[99]

4.13 Within this framework subsisting governance arrangements were diagrammatically illustrated as follows[100]:



[99] Agreement between City of Edinburgh Council with Transport Initiatives Edinburgh (TIE) Limited – May 2008 CEC00478603
[100] Agreement between City of Edinburgh Council with Transport Initiatives Edinburgh (TIE) Limited – May 2008 –Page 17 CEC00478603

4.14 Whilst such a framework could potentially have provided clarity in responsibilities evidence suggests that in reality the practical position was somewhat different:

- Governance structures overly complex and ineffective – both original Tram Project Board interfacing and post 2011 revised governance arrangements
- Key individuals serving in multiple roles
- Key CEC executives have insufficient time to devote to the management and scrutiny of the project
- Lack of accountability for performance – inability to hold Tie to account in initial stages – failure of CEC to apply rigour in holding Tie to account on performance
- Undue reliance on Tie to construct complex procurement arrangements

3. **Good governance means promoting values for the whole organisation and demonstrating the values of good governance through behaviour**

3.1 Putting organisational values into practice

3.2 Individual governors behaving in ways that uphold and exemplify effective governance

4.15 Relevant issues arising include the following:

- Defensive positions adopted by some Tie Executives
- Sub-optimal management behaviours/styles – concealment and negative behaviours
- Lack of transparency and openness between Tie and CEC

4. **Good governance means taking informed, transparent decisions and managing risk**

4.1 Being rigorous and transparent about how decisions are taken

4.2 Having and using good quality information, advice and support

4.3 Making sure that an effective risk management system is in operation

4.16 Relevant issues arising include the following:

- Flawed Infraco contract formulation – lack of legal and financial scrutiny – lack of clarity and transparency from Tie was a significant contributory factor
- Risk Management process well-structured but ineffective in practice
- Failure of CEC to fully manage project risks – undue reliance placed on Tie
- Project ‘Lock in’ evident around Financial Close 2008 and around aspects of mediation and 2011 progression – undue haste to achieve Financial Close in May 2008 – lack of considered approach
- Project ‘lock in’ failure to fully consider financial implications of abandonment
- Members were asked to agree to a contract where the project design was substantially incomplete and the contractor consortium had a significant role in designing ‘their own brief’
- Audit Committee scrutiny inadequate – improved focus provided by the Governance Risk and Best Value Committee (often known as GRBV) from October 2011

5. **Good governance means developing the capacity and capability of the governing body to be effective**

5.1 Making sure that appointed and elected governors have the skills, knowledge and experience they need to perform well

5.2 Developing the capability of people with governance responsibilities and evaluating their performance, as individuals and as a group

5.3 Striking a balance, in the membership of the governing body, between continuity and renewal

4.17 Relevant issues arising include the following:

- Lack of competency framework or appraisal system
- Lack of robust operational and financial performance management
- Lack of capacity from specific CEC and Tie executives to devote to specific tasks due to other commitments

6. **Good governance means engaging stakeholders and making accountability real**

6.1 Understanding formal and informal accountability relationships

6.2 Taking an active and planned approach to dialogue with and accountability to the public

6.3 Taking an active and planned approach to responsibility to staff

6.4 Engaging effectively with institutional stakeholders

4.18 Relevant issues arising include the following:

- Dissonance in relationship between Tie and CEC significantly impaired transparency, performance management and overall management of high level risks
- Unrealistic cultural positioning – failure to fully consider that Tie was an extension of CEC regardless of its actual legal entity status
- Changed towards a co-ordinated response from 2011 with significantly improved stakeholder dialogue
- Lack of wider awareness on the impact on future Council tax payers regarding the CEC funding a £247.162m gap through prudential borrowing

4.19 Although there is evidence that CEC and Tie sought to put in place strong governance surrounding the Tram Project some of the mechanisms were ineffective. A combination of overly complex reporting lines, lack of rigour in CEC's oversight of Tie, sub-optimal management strategies and behaviours around the construction on complex contracts, dissonance and lack of trust in the relationship with Tie together with project 'Lock In' conspired to place a significant drag on the ability of the project to be delivered. A renewed focus with stronger arrangements from mid-2011 allowed for a final push to achieve final project implementation in 2014.

5. Concluding Comments

5.1 Whilst the Edinburgh Tram Project had a governance framework in place which could potentially have delivered robust scrutiny and effective decision making there was a significant cultural and management disconnect between CEC and its wholly owned company Tie Ltd which significantly impaired the effectiveness of these arrangements. The inherent assumption demonstrated by some CEC officials within witness evidence suggesting that the Tie special purpose vehicle (SPV) would be able to insulate CEC from the assumption of risk was fundamentally flawed in the context of the political and operational considerations within which this ambitious infrastructure project was being managed.

5.2 We consider that it was premature to deliver a financial close in May 2008 whilst the design was not fully completed and there were delays with the utilities work. Decision makers may not have been fully informed of the potential risks in entering a highly complex contractual position. There may have been insufficient time for the numbers to be fully considered. In addition, decision makers may not have been fully informed that the highly complex contractual position, in reality, set the conditions which ended with conflict, delay and a significant recalibration of outcomes. However, from 2011 there appears to be an appreciable improvement in the rigour applied by CEC in the management of the project.

5.3 The Edinburgh Tram Project was a highly complex infrastructure project where outcomes and their financing were significantly distorted by a wide range of factors including the differing expectations of parties involved, incorrect assumptions on accountability and a fundamental misapprehension on the transfer of risk on public projects. There is no evidence to suggest that the City of Edinburgh Council failed to comply with statutory requirements around Prudential Borrowing or Best Value. Local authorities are creatures of statute and the regulatory mechanism in place around financial reporting, prudential borrowing and best value as audited by Audit Scotland is robust covering all 32 local authorities in Scotland. Consistent with standards of compliance applied by all 32 local authorities highlighted through statutory audit we were not expecting any contra indicators to be highlighted within the evidence in scope. However, in relation to the Tram Project compliance with prevailing good practice on governance and financial management was found to be variable over the currency of the project and partial at best.

5.4 Governance arrangements were invariably complex, for example – overly complicated reporting lines which were 'blurred' in practice. Prior to 2011 sub-optimal behaviours from key project contributors including apparent concealment, and/or a lack of transparency, provided an element of negativity which contributed to a level of dissonance in relationships between key stakeholders. A perception arising from our review was that there was more focus on the CEC/Tie executives promoting and protecting their own operational interests rather than working together on driving the achievement of ultimate common project outcomes.

5.5 A combination of overly complex reporting lines, lack of rigour in CEC's oversight of Tie, sub-optimal management strategies and behaviours around the construction on complex contracts, dissonance and lack of trust in the relationship with Tie together with project 'Lock In' conspired to place a significant drag on the ability of the project to be delivered.

5.6 We are strongly of the view that project 'Lock In' was a key inhibiting behavioural factor. Project Lock-in is a behavioural dissonance where objectivity in decision making is impaired due to decision makers and advisers being unable through behavioural influences to consider all available options. This tends to happen when commitments or investment made are deemed to be too large to warrant significant change or termination of a project regardless of the merits of considering such options. However a renewed focus with stronger arrangements from mid-2011 onwards allowed for a final push to achieve final project implementation in 2014.

5.7 We do not believe that the option for terminating the project in 2010/11 was given adequate consideration nor was the financial implications and funding requirements arising from meeting the project forecast spend of approximately £776m first highlighted in the CEC Accounts of 2010/11. The available evidence does not show that the consequences of such financing by CEC were fully appreciated including the annual impact of some £75.43 of Band D equivalent on Council Tax payers. Indeed, the approach adopted in securing the borrowing of gap funding of £247.162m beyond the agreed CEC exposure of £45m and the original Scottish Government Grant funding of £500m does not appear to recognise the opportunity costs to CEC of committing revenue financing costs of repayment and interest.

5.8 In terms of prevailing standards of good practice, financial risks were not appropriately managed and it would be difficult to establish the premise that value for money has been delivered on the final project.

5.9 In summary, whilst some aspects of good governance and financial management were in place such frameworks were significantly undermined prior to 2011 by an absence of a robust CEC led strategic planning and contract management capability including operational and financial performance management.

Appendix 1

Sources of Evidence

	Area	Number of documents	Starting reference	Title/Purpose
	ADJUDICATIONS	**8**	**BFB00053300 BFB00053391 BFB00053462 BFB00053475 BFB00053489 BFB00053622 BFB00094593 WED0000026**	**Mediation Statements/Adjudications – Tie v Infraco**
	ASSETS	**10**	**CEC02087283 CEC02086465 CEC02086457 to CEC02086464**	**Letter – dated 31 March 2017 Tram related assets on Balance Sheet 8 Excel Workbooks**
	AUDIT SCOTLAND	**13**	**ADS00046 ADS00045 ADS00072 ADS00073 ADS00049 ADS00050 ADS00051 ADS00052 ADS00053 ADS00074 ADS00075 ADS00076 ADS00077**	**Interim Report - Edinburgh Tram Project – February 2011 City of Edinburgh Council - the Audit of Best Value and Community Planning – May 2013 Report to Members - Audit 2005/06 Report to Members - Audit 2006/07 Report to Members - Audit 2009/10 Report to Members - Audit 2010/11 Report to Members - Audit 2011/12 Report to Members - Audit 2012/13 Report to Members - Audit 2013/14 Report to Members - Audit 2014/15 Report to Members - Audit 2015/16 Report to Members of the Governance Risk and Best Value Committee – 25 Sept 2015 Report to Members of the Governance Risk and Best Value Committee – 26 Sept 2016**
	BILFINGER BERGER	**14**	**BFB00003305 BFB00005467 BFB00005631 BFB00053258 BFB00053260 BFB00053300 BFB00053391 BFB00053462 BFB00053475 BFB00053482 BFB00053489**	**Infraco Contract Period Reporting – April 2012 Legal documents and updates including adjudications**

			BFB00053622 BFB00094593 BFB00097935	
	BORROWING	**1**	**WED00000646**	**International Accounting Standard 16 Property,Plant and Equipment**
	BUSINESS CASE – WEST TRAM LINE	**1**	**TRS00018617**	**Transport Initiatives Edinburgh (TIE) – Edinburgh Tram Network STAG Report Line Two – 31 March 2004**
	BUSINESS CASES AND ESTIMATES	**4**	**CEC01757854** **CEC01758866** **CEC01758931** **ADS00017**	**Edinburgh Tram Network – Scope Options** **Draft Final Business Case – 16.11.06 – TEL Board recommendation to CEC Members** **ETN Draft Business case – November 2006** **Infraco Draft Analysis and Updated Project Cost Estimate – Response to Transport Scotland 2007**
	BUSINESS CASE OUTLINE – APPROVED	**1**	**USB00000232**	**New Transport Initiative – Framework for Delivery – May 2002**
	CEC/TIE LTD AGREEMENTS	**2**	**CEC00478603** **CEC01315172**	**CEC and Tie Limited – Sept 2005/CEC and Tie Limited May 2008**
	CEC ANNUAL REPORT AND ACCOUNTS	**14**	**CEC02084260** **CEC02084261** **CEC02084262** **CEC02084263** **CEC02084264** **CEC02084265** **CEC02084266** **CEC02084267** **CEC02084340** **CEC02084341** **CEC02084342** **CEC02084343** **CEC02084344** **CEC00860552**	**Annual Report and Account – 2003/2004 – 2014/2015**
	CONTRACT AWARD AND SCHEDULE	**4**	**USB00000357** **USB00000032** **TRS00011725** **TRS00017180**	**Reports to Members - Policy and Strategy Committee May 2008 and Council August 2011 and Schedule 4 – USB00000032**
	DELIVERY FRAMEWORK	**1**	**USB00000228**	**Report to Council – New Transport Initiatives – Next Steps – October 2001**
	DISPUTE RESOLUTION	**1**	**CEC01001220**	**Tie Board/Tie Project Board – Dispute Resolution Procedure – 11 March 2009**
	FINAL COSTS	**6**	**CEC02085663** **CEC02085664** **CEC02085665** **CEC02085666** **CEC02085667** **CEC02085668**	**Turner and Townsend – Final Cost Statements**
	FINANCE CLOSE	**1**	**TRS00017180**	**Report to Tram Sub-Committee dated 16 June 2008 by Directors of City Development and Finance**
	GOVERNANCE	**6**	**CEC01315172** **CEC00478603** **CEC01758865** **CEC01803822** **TIE000000905** **TIE000000906**	**Governance arrangements/framework including governance mapping**

	GRANT FUNDING – SCOTTISH GOVT.	**2**	**TRS00014693** **TRS00011741**	**January 2008 committed grant agreement and confirmation of continued grant – March 2011**
	GUARANTEES	**1**	**BFB00097935**	**Guarantee Agreement between CEC and Bilfinger Berger UK Ltd and Siemens PLC – 15 September 2011**
	LITIGATION	**1**	**CEC01942219**	**Litigation spreadsheet – McGrigors LLP**
	MONTHLY REPORTS	**70**	**CEC00023062** **CEC00024302** **CEC00113636** **CEC00113637** **CEC00113638** **CEC00113639** **CEC00113640** **CEC00113641** **CEC00376398** **CEC00472633** **CEC00472988** **CEC00474413** **CEC00474810** **CEC00474817** **CEC00679481** **CEC00680381** **CEC00681325** **CEC00883330** **CEC00885508** **CEC00907334** **CEC01019351** **CEC01049517** **CEC01049981** **CEC01049981** **CEC01050241** **CEC01080092** **CEC01126847** **CEC01157265** **CEC01157404** **CEC01164912** **CEC01210435** **CEC01246656** **CEC01246951** **CEC01247012** **CEC01247014** **CEC01247015** **CEC01359509** **CEC01362481** **CEC01365560** **CEC01369999** **CEC01453303**	**Period CEC Monitoring Reports – 2006/2012**

			CEC01499243 CEC01517471 CEC01622996 CEC01786920 CEC01792379 CEC01797337 CEC01914523 TIE00099961 TIE00107986 TIE00134356 TIE00349088 TIE00689399 TIE00794365 TRS00002789 TRS00002791 TRS00002935 TRS00004183 TRS00004377 TRS00004404 TRS00004495 TRS00004499 TRS00004500 TRS00004588 TRS00004592 TRS00004765 TRS00004766 TRS00004836 TRS00005128 TRS00019057	
	OGC REVIEWS	**2**	**CEC01562064** **CEC01496784**	**Tie Project Gateway 3 Review – 9 October 2006** **Tram Project Risk Review – 15 October 2007**
	PROCUREMENT	**1**	**WED00000023**	**BBS Consortium – Preferred Bidder Status Conditions – 9 May 2008**
	PROJECT LOCK IN	**1**	**WED00000644**	**Institute of Government - What's wrong with infrastructure decision making?**
	PROJECT MANAGEMENT	**1**	**TRS00023933**	**Hg Group – Review of Progress and Management of the Project – Jan 2011-June 2012**
	STATEMENTS – WITNESS	**5**	**TRI00000160** **TRI00000055** **TRI00000060** **TRI00000022** **TRI00000153**	**Gill Lindsay** **Alastair Maclean** **Donald McGougan** **Tom Aitchison** **John Connarty**
	STRATEGIC OPTIONS	**1**	**CEC01010129**	**Tie Board/Tram Project Board – Strategic Options – Update & Forward Planning – 15 April 2009**
	TIE BOARD	**1**	**CEC01358513**	**Presentation to Tie Board – 15 October 2007**
	TIE LTD - COMPANIES HOUSE REGISTRATION	**15**	**TIE00899953** **TIE00899955** **TIE00899956** **TIE00899957**	**Incorporation/Change of Name** **Annual Accounts lodged – 2002/2003** **Annual Accounts lodged – 2003/2004** **Annual Accounts lodged – 2004/2005**

			TIE00899958 TIE00899959 TIE00899960 TIE00899961 TIE00899948 TIE00899949 TIE00899950 TIE00899951 TIE00899952 TIE00899962	Annual Accounts lodged – 2005/2006 Annual Accounts lodged – 2006/2007 Annual Accounts lodged – 2007/2008 Annual Accounts lodged – 2008/2009 Annual Accounts lodged – 2009/2010 Annual Accounts lodged – 2010/2011 Annual Accounts lodged – 2011/2012 Annual Accounts lodged – 2012/2013 Annual Accounts lodged – 2013/2014 Application to Strike Off Register
	TIE LTD – DELIVERY STRATEGY	1	CEC01709208	Tie Limited – Tram Project Board – Delivery Strategy – Feb 2007
	TIE LTD – MONTHLY PROJECT REPORTS	2	CEC01758069 CEC01758070	Monthly/Period Performance Updates including ancillary reports – 2005
	TRAM PROJECT BOARD	83	TIE00090570 TIE00090572 TIE00000905 TIE00000906 TIE00059601 TIE00064616 TIE00090588 TIE00090591 TIE00090593 CEC01355258 CEC01360998 CEC01688881 CEC01695695 CEC01758865 CEC01788433 CEC00688584 CEC00699788 CEC01015822 CEC01018359 CEC01023764 CEC01246825 CEC01246826 CEC01357124 CEC01359648 CEC01526422 CEC01552419 CEC01561047 CEC01565576 CEC00079774 CEC00079902 CEC00080738 CEC00114831	2005 2006 2007 2008

			CEC00988024 CEC00988028 CEC00988034 CEC01015023 CEC01053637 CEC01050731 CEC01210242 CEC01363703 USB00000005 USB00000006 CEC00416111 CEC00573427 CEC00633071 CEC00681328 CEC00842029 CEC00843272 CEC00848256 CEC00888781 CEC00983221 CEC00988036 CEC01001220 CEC01010129 CEC01021587 CEC00013703 CEC00013818 CEC00014055 CEC00014175 CEC00223543 CEC00244400 CEC00245907 CEC00261936 CEC00420346 CEC00473005 CEC00474418 TIE00894384 TIE00896978 TIE00896987 TIE00897052 TIE00897056 TIE00897058 TIE00897064 TIE00897066 TRS00000329 TRS00001954 TRS00002066	2009 2010 2011

			TRS00002066 **TRS00002067** **TRS00002102** **TRS00002175** **TRS00002656** **TRS00003014** **TRS00004079**	

Appendix 2

Glossary/Terminology

The following terminology is representative of finance terminology used in local authorities in Scotland over the period of the Tram Project:

Capital & Revenue	Accountants classify expenditure into capital and revenue. Capital expenditure is generally expenditure on items that produce benefits for periods longer than a year. The benefits from revenue expenditure are usually consumed within a year. A new building would be an example of capital expenditure. It would be anticipated that benefit would be gained from it for much longer than one year. Conversely, heating the building produces quite short term benefit – for the period of time the heating is switched on and would be classified as revenue expenditure. Salaries and wages are an interesting case. Accountants would almost always class them as revenue although it could be debated that the benefits from a stable workforce are felt for more than one year. Accounting is consistent if not always logical!
CFCR	**Capital Financed from Current Revenue** Local authorities may choose to finance (i.e. to meet the cost of) some or all of their capital expenditure from their revenue (or current) resources. Expenditure financed by this method is known as "capital financed from current revenue".
GAE	**Grant Aided Expenditure** Each year the Scottish Executive forms its own view as to how much it considers that local authorities require to spend to provide a "standard" level of service. That is the "Grant Aided Expenditure" assessment. The intention of the GAE system is to ensure that, if each authority spent at its GAE level the council tax would be set at the same level throughout Scotland.
AEF	**Aggregate External Finance** In addition to deciding on GAE the Scottish Executive also forms a view as to how much money Council's ought to raise from local resources, primarily the Council Tax. Once it has made that judgement then the gap – and there is always a gap – between that and GAE represents the amount of financial support that the Executive will give to local authorities – Aggregate External Finance.
NDRI	**Non Domestic Rate Income** Income received by local authorities in respect of non-domestic premises or 'business rates'. There is a single national rate poundage applied to the rateable value of such premises and the resulting income is collected by each local authority. The amount collected is 'pooled' nationally and then redistributed to local authorities in proportion to their population. NDRI is a component of AEF.
RSG	**Revenue Support Grant.** Once the Scottish Executive has decided on the amount of money it wishes to provide to local authorities in support of their services – the amount of AEF – it deducts from that total the value of specific grants – those that are paid in connection with a particular initiative or service, such as Police – and the value of NDRI. The balance is RSG. It is therefore a residual amount, with no basis for its calculation other than the one described.

GSE	**Government Support Expenditure.**

Capital expenditure incurred by local authorities that is financed from borrowing or from certain forms of leasing, results in loan and leasing charges. The cost of these is met by the Scottish Executive i.e. government support and when this is added to GAE the total is referred to as Government Support Expenditure.

LGFS **The Local Government Finance Settlement**

The announcement of the amounts of GAE and AEF made by the Scottish Executive.

PPP **Public Private Partnership**

It has been a policy of government (both Scottish and UK) for some years now that local authorities should involve the private sector in the finance and operation of their activities. Public Private Partnerships is the general name used to refer to any partnership between a local authority (or indeed any other public body) and the private sector that is aimed at helping local authorities to deliver the services that they provide.

PFI **Private Finance Initiative**

PFI is a special form of PPP. Under PFI, the private sector would design, build and operate an asset (for example a school) that would be used by the local authority. The authority would pay an annual amount for the use of the school, and would probably provide the teaching staff to run it. Operating costs such as heating, cleaning and maintenance would be the responsibility of the private sector partner. The authority would contract to use the school for a long period of time, probably 30 years. At the end of that period the school may remain in the ownership of the private company or, more commonly now, might revert to the local authority. The attraction of this scheme from the Scottish Executive's point of view is that, providing certain conditions are met, the construction of the school does not count as public expenditure. One of the key macroeconomic policies of the present UK government is that public expenditure as a proportion of the national "cake" should be kept at a prudent level. There are also specific constraints on public expenditure that arise if the UK wishes to join the single European currency, the Euro. For these and other reasons control (which usually means restriction) of public expenditure is a key aim of the government.

VFM **Value For Money**

Value For Money is an assessment of the extent to which a product, service or activity displays the characteristics of economy, efficiency, effectiveness and now a further e' the need to meet equal opportunity requirements. (see also the "4 Es"). The Accounts Commission has a statutory duty to assess VFM in respect of local authority services.

The "4 E's" **Economy, efficiency, effectiveness & need to meet equal opportunity requirements.**

Economy is an assessment of the extent to which a product, service or activity is being produced at lowest cost for any given level of quality. Efficiency is a measure of the ratio of output to input. Effectiveness measures the extent to which a product, service or activity "does the right thing". VFM previously was referred to in terms of the 3 E's. The Local Government in Scotland Act 2003 introduced the 4th E which is the need to meet equal opportunity requirements. These requirements as in Section L2 of Part II of Schedule 5 to the Scotland Act 1998 (c.46). The measures are usually taken together as representing the extent to which there is Value For Money.

Best Value An initiative introduced by the government in 1997 as a means of encouraging local authorities to improve their performance. It requires authorities to challenge their existing ways of delivering services, compare their costs with other authorities and external bodies, consult with consumers and stakeholders over the services that should be delivered and where appropriate to subject services to competition from outside. It was introduced to an extent as a replacement for the Compulsory Competitive Tendering regime (CCT), although competition has been retained as an element of it. The Local Government in Scotland Act 2003 introduced a statutory duty of Best Value with effect from 1 April 2003.
The "4 Cs" Challenge, Compare, Consult, Compete. The broad measurement criteria for Best Value.
HRA Housing Revenue Account. A statutory account of the income and expenditure associated with a local authority's council housing stock and activities. The account is 'ring fenced' i.e. the authority is not allowed to use any part of its general income to finance it. This has the effect of requiring authorities to ensure that the income from rents collected is sufficient to meet the cost of operating and maintaining the properties.
The Prudential Code Local authorities have a statutory duty to keep under review the maximum amount that it can afford to allocate to capital expenditure. From April 2004, The Prudential Code developed by CIPFA became by regulation the self-regulatory mechanism or framework to enable this. The Code aims to ensure that capital investment plans of local authorities are affordable, prudent and sustainable.
PWLB Public Works Loan Board A body that exists to provide loans – usually for capital purposes – to local authorities and other public bodies. Being part of government means that the PWLB is able to raise money at highly competitive rates of interest.
DSM Devolved School Management An initiative designed to give control of resources to individual schools, by allowing them to make decisions about their budgets and how they should be spent.

CIPFA FINANCIAL MANAGEMENT MODEL – EXTRACT OF STATEMENTS AND SUPPORTING QUESTIONS- APPENDIX 3

Securing Stewardship – Leadership		Selection
L1	**The organisation has an effective framework of financial accountability that is clearly understood and applied throughout, from the *Board* through executive and non-executive directors to front line service *Managers.***	
1.	Does the *Board* set the tone that finance matters?	
2.	Are there written *governance* arrangements which define the financial management roles and responsibilities of the *Board*, relevant *governance* groups and of the *Chief Executive* and senior *Managers*, underpinned in more detail by financial regulations and contract procedures?	
3.	Is the *Board* given a consolidated view of the organisation's finances and risks, including from subsidiaries and important deliver partners?	
4.	Does the organisation have an effective *Audit Committee*?	
5.	Do the organisation's governance arrangements comply with the sector's code of corporate governance, reflecting Nolan standards of ethical behaviour and public accountability?	
6.	Are external audit or inspection reports free from governance concerns?	
7.	Does the *Audit Committee* receive and monitor the implementation of internal and external audit recommendations?	
8.	Is there a professionally qualified *Chief Financial Officer*?	
9.	Is the *Chief Financial Officer a* member of the *Leadership Team*, reporting directly to the *Chief Executive* and with direct access to the *Board and Audit Committee*?	
10.	Is the scope of the *Chief Financial Officer's* other management responsibilities reviewed to ensure their focus on financial matters is not compromised?	
11.	Is there a line of professional accountability between those with principal functional responsibility for finance within the business and the *Chief Financial Officer, to* ensure standards of compliance and objectivity of advice on financial matters?	
12.	Are shared accountabilities and commitments between the finance function and other business areas clearly defined?	
13.	Is the external auditor's annual letter considered by the *Board* and *Audit Committee*, with recommendations factored into future years work programmes?	
14.	Does the organisation publish an Annual Governance Statement or Statement on Internal Control, including internal financial control and risk management, signed by the *Chief Executive*?	
15.	Is there a published annual report that conforms to appropriate standards and sector requirements?	
16.	Do senior *Managers* demonstrate an understanding of the financial management rules by actually applying them?"	
17.	Do decision reports include advice written or signed off by *Finance staff* on financial implications and value for money?	

Securing Stewardship – Leadership		Selection
L2	**The organisation's leadership allocates resources to different activities in order to achieve its objectives and monitors the organisation's financial and activity performance.**	
1.	Do the *Medium-term Financial Plan* and budget show the resources allocated to major spending activities and programmes, with useful summaries?	
2.	Is the financing of expenditure transparently explained in the budget summaries and reports?	
3.	Does the *Medium-term Financial Plan* project forward the financial position for at least three years?	
4.	Does the *Board* review activity levels, actual spend, balance sheet items, and forecast outturn against the budget, at a minimum quarterly, to ensure the organisation will not overspend and that income and expenditure are in line with budgets and agreed policy, and is achieving planned outcomes?	
5.	Do the *Management Team* review activity levels, actual spend, balance sheet items, and forecast outturn against the budget monthly, to ensure the organisation will not overspend and that income and expenditure are in line with budgets and agreed policy, and is achieving planned outcomes?	
6.	Does the *Leadership Team* monitor Key Performance Indicators at least quarterly?	
7.	Is financial information relevant, clearly presented, timely and comprehensible to the non-financial reader? This applies to *Board* member reports as well as *Management Team* reports.	
8.	Are budgets realistic, with over- and under-spending within expected tolerances?	
9.	Are there governance arrangements for scrutiny, review and challenge of the draft budget, including stakeholder consultation?	
10.	Are there processes to adjust budgets in year and to seek *Board* or *Management Team* level approval if major programmes are varied by more than pre-set tolerances?	
11.	Are decisions to change resource allocations transparent, justified and made in accordance with the organisation's rules?	
12.	Has the organisation a policy to avoid reliance on one-off resources to finance recurrent expenditure?	
13.	Has the organisation a declared policy on treatment of over- and under-spending, including end of year flexibility?	
14.	Does the *Leadership Team* receive reports that show clearly the impact of current allocations and performance on future years?	

Supporting Performance – Leadership		Selection
L3	**The organisation integrates its business and financial planning so that it aligns resources to meet current and future business objectives and priorities. Performance management is conducted through measures of service delivery and clear understanding of the costs incurred.**	
1.	Does the organisation operate to clear criteria for reviewing and justifying its activities, expenditure and income policies, including the need for public subsidy, the economic value provided, the impact on people most in need, the risks involved and alternative agents of delivery?	
2.	Does the *Corporate Business Plan* demonstrate how resources are allocated strategically to deliver the organisation's aims, objectives and priorities?	
3.	Does the *Medium-term Financial Plan* draw together realistic estimates of funding to support the achievement of strategic objectives?	
4.	Does analysis of the medium term financial environment form an explicit backcloth to the *Corporate Business Plan*?	
5.	Is formulation of the *Corporate Business Plan,* or the linked financial plan, based on analysis of cost implications of policy choices?	
6.	Is the *Corporate Business Plan* developed in collaboration with delivery partners and stakeholders?	
7.	Do delivery partners' plans align with the *Corporate Business Plan*?	
8.	Does the *Medium-term Financial Plan* examine scenarios to develop financial flexibility, adequate contingency and reserves, based on a risk assessment and sensitivity analysis?	
9.	Do the *Corporate Business Plan* and *Medium-term Financial Plan* address the impact of key external cost drivers: social trends; demographics and changes in service demand; and accelerating commitments? Major examples include elderly social care, waste disposal, pensions, interest rates, environmental sustainability.	
10.	Does the *Leadership Team* approve and understand the demand management strategies for demand led services and activities?	
11.	Does the *Board* and *Management Team* regularly review priorities to enable resources to be redirected from areas of lesser priority, not relying principally on pro rata cuts to generate savings?	
12.	Does the *Corporate Business Plan* or the linked financial plan; reflect efficiency targets, over a medium term time horizon?	
13.	Is the *Corporate Business Plan* underpinned by clear and coherent operational plans, workforce plans, and procurement plans?	
14.	Is the *Corporate Business Plan* reviewed and updated on a regular basis?	
15.	Do measures used for performance management link outputs and outcomes with costs?	
16.	Does *Board* and *Management Team* reporting bring together information on financial performance, activity levels, outcomes and risk?	
17.	Does monitoring of performance give rise to rapid response and corrective action?	
18.	Do external audit and inspection comment favourably on the processes for planning and review?	

Supporting Performance – Leadership		Selection
L4	**The organisation has a developed financial management strategy to underpin long term financial health.**	
1.	Does the *Leadership Team* demonstrate commitment to the strategy for long term financial health through their statements and actions?	
2.	Does the organisation review the balance of funding streams to ensure long term financial health, fairness to users, and development of the local economy, for example between tax raising, grant funding and charges?	
3.	Are there clear financial management policies that together underpin sound and sustainable long term finances? Policies may include accounting practices, approach for bidding for external resources, levels of contingency funds and reserves, procurement, asset management, business cases, affordability of capital investment, efficiency gains and targets, financial risk management, risk financing and insurance, treasury management, wider market and trading opportunities, charges and subsidies for users.	
4.	Do financial management policies support strategic business aims, resilience and financial standing?	
5.	Are financial management policies communicated to *Managers* and the *Management Team,* widely understood and consistently applied?	
6.	Does the *Board* or *Audit Committee* receive assurance on compliance with financial management policies and on the follow up of material deviations?	
7.	Are financial management policies reviewed regularly and updated?	
8.	Do post-completion project reviews take place and include identification of actions to improve financial management?	
9.	Do external audit and inspection comment favourably on the processes for strategic risk management, resilience and financial standing?	

Supporting Performance – Leadership		Selection
L5	**The organisation uses financial management expertise in its strategic decision-making and its performance management based on an appraisal of the financial environment and cost drivers.**	
1.	From *Board* level and throughout, are *Finance staff* involved and influential in their business area's strategic planning and decision reporting?	
2.	Are decisions informed by a detailed understanding of cost drivers and sensitivities affecting the principal activities (whether current or planned)?	
3.	Do *Finance staff* give appropriate support and challenge to decision-makers so they understand the financial implications and value for money of policy options?	
4.	Are there project appraisals and affordability tests for new capital investment that assess thoroughly the anticipated benefits and costs?	
5.	Are there business cases and affordability tests for new policy developments that assess thoroughly the anticipated outcomes and costs?	
6.	Do decision reports focus on whole life costs so that comparisons can be made with alternative provision?	
7.	Are there business cases, including considering risk and impact assessments, affordability and delivery performance, when considering disinvestment, service reductions or increased charges?	
8.	Are unit costs, activity costs, benchmarks and other financial performance ratios available and used to inform decisions to maintain or change current services?	
9.	Does *Board* and *Management Team* reporting bring together information on financial performance ratios, activity levels and risk?	
10.	Is the *Leadership Team* committed to using relevant data in its decision making (rather than intuition)?	
11.	Do the *Board* and *Management Team* regularly review the continuing affordability and value for money of its capital investment programme?	

Enabling Transformation – Leadership		Selection
L7	**The organisation's leadership integrates financial management into its strategies to meet future business needs. Its financial management approach supports the change agenda and a culture of customer focus, innovation, improvement and development.**	

1.	Does the *Board* and the *Management Team* rethink and reformulate its business model to respond to a changing environment and new ideas?	
2.	Is an understanding of financial implications, opportunities and risks integral to developing new business models and alternative service delivery mechanisms?	
3.	Are performance and cost measures, including comparative and 'best in class' information, used by the *Board* and senior *Managers* to indicate business areas where radical rethinking of delivery is needed?	
4.	Do future financial scenarios act as a spur for innovation and change?	
5.	Does the *Leadership Team* actively develop mechanisms to secure new capacity and resources for the organisation?	
6.	Are emerging markets and demands identified and their financial implications allowed for?	
7.	Are funds earmarked to facilitate innovative or invest to save projects?	
8.	Are financial benefits integral to the realisation of benefits from change programmes?	
9.	Does the *Board* reporting strike an appropriate balance between 'business as usual' and development/change activities?	
10.	Is evidence, including customer insight, at the core of policy and resource planning?	
11.	Is a joined-up/cross-cutting approach adopted in change plans and reflected in budgets and accountability?	
12.	Are financial and service benefits defined, and a benefits realisation plan drawn up, before embarking on major developments?	
13.	Are affordability, value for money and risk transfer/management calculations an integral part of project appraisal and business plans?	
14.	Has the organisation a track record in programme and project management, including delivering planned outcomes within budget?	
15.	Is the organisation prepared to stop projects that lose sight of planned benefits for planned resource inputs?	
16.	Can the organisation point to successful change projects which have realised financial as well as business improvements?	
17.	Is financial sustainability considered a core value in the organisation's strategy and business cases?	
18.	Does the organisation systematically seek to lever the benefits of technology and IT from one area into others to produce organisation wide benefits?	

Securing Stewardship – People		Selection
P1	**The organisation identifies its need for financial competencies and puts arrangements in place to meet them.**	
1.	Is there a financial management competency framework that identifies competencies needed at different levels of responsibility throughout the organisation?	
2.	Are posts that include responsibility for budgets and spending required to have specified financial competencies?	
3.	Are these financial competencies reflected in individual job descriptions and person specifications?"	
4.	Does the organisation's appraisal scheme include financial competencies where these are required?	
5.	Are the financial competency requirements of posts reviewed regularly?"	

6.	Are financial training needs of staff identified from induction and appraisals and met in a structured, flexible and timely manner?	
7.	Are the financial competencies and training needs of *Board* members and *non-executives* identified and met in a structured, flexible and timely manner?	
8.	Are the outcomes of financial management training evaluated?	
9.	Do *Finance staff* consider that *Managers* have appropriate finance skills and experience to enable cost effective delivery?	
10.	Do *Managers* consider that *Finance staff* have appropriate skills and experience to support them in financial matters?	
11.	Do external auditors and inspectors comment favourably on the financial competencies of the organisation?	

Supporting Performance – People		**Selection**
P3	***Managers* understand they are responsible for delivering services cost effectively and are held accountable for doing so.**	
1.	Do *Managers'* performance targets include measures of cost effectiveness, such as savings targets, performance improvements etc?	
2.	Are *Managers* at all levels held accountable for performance and financial outcomes, with meaningful consequences for their appraisal?	
3.	Are *Managers* at all levels held accountable for the value for money implications of their decisions, with meaningful consequences for their appraisal?	
4.	Are market-like mechanisms developed for internal support services to drive efficiency?	
5.	Are challenge and support from *Finance staff* sought and taken account of by *Managers* in their policy decision and delivery role, and at *Board* level?	
6.	Do *Managers* and *Finance staff* regularly discuss benchmarks and trends for cost drivers?	
7.	Do *Managers* actively consider the cash flow implications of the way they do business?	
8.	Does the organisational culture recognise and reward efficiency and cost reduction?	
9.	Do external auditors and inspectors comment favourably on the value for money performance of the organisation?	

Enabling Transformation – People		**Selection**
P5	**Financial literacy is diffused throughout the organisation so that decision takers understand and manage the financial implications of their decisions.**	
1.	Are strong finance skills and experience evidenced by the way in which decisions are taken at *Board* level and throughout the organisation?	
2.	Do *Board* members have the skills and knowledge to challenge the *Chief Executive* or *Chief Financial Officer*?	

3.	Is the culture of financial awareness sustained by regularly briefing the *Leadership Team* and *Managers* on emerging financial issues to be reflected in strategic planning?	
4.	Is there evidence that *Managers* take individual and collective responsibility for maximising the quantity and quality of public services delivered for the minimum of resources used?	
5.	Is there evidence that *Managers* and *Finance staff* work closely together at all levels to continuously improve value for money and performance?	
6.	Is there evidence that the *Managers* and *Finance staff* in the organisation are considered by their peers to lead in performance for their sector (e.g. external awards, beacon status, fellow professionals)?	
7.	Do external audit and inspectors view the organisation as amongst those best in class for value for money?	

Enabling Transformation – People		**Selection**
P6	**The organisation develops and sustains its financial management capacity to help shape and support its transformational programme.**	
1.	Do *Finance staff* develop their knowledge over a range of structural mechanisms, eg trading companies, regeneration financing, and joint ventures)?	
2.	Do *Finance staff* have appropriate commercial acumen and negotiating skills to act for the organisation effectively?	
3.	Are *Finance staff* valued members of project and programme teams dealing with complex and long term schemes, eg infrastructure renewal?	
4.	Does the organisation encourage its *Managers* and *Finance staff* to share and develop best practice through internal and external networks?	
5.	Are *Finance staff* encouraged to spend time experiencing front line delivery and the customer experience, to better understand service delivery and performance?	
6.	Are *Managers* and *Finance staff* given the opportunity to think creatively away from day to day pressure?	
7.	Are financial training needs arising from the transformation and VFM agenda anticipated and met in a structured, flexible and timely manner?	
8.	Does the organisation attract, develop and retain the calibre of financial management skills in its people?	
9.	Does the organisation build internal knowledge and capacity in financial management (e.g. in change and project management, new delivery and financial structures, innovative financing, e-government, process redesign)?	
10.	Does the organisation systematically learn from the best in class, e.g. through for transferring financial expertise from consultants and partners, benchmarking, involvement in networks?	
11.	Has the organisation adapted the shape and expertise of its finance function for new challenges?	
12.	Are there processes for reflection on success or failure in order to identify learning points?	

13.	Is success and innovation in financial management recognised, for example through innovation awards, good practice case studies for peers to learn from or financial reward?	

Securing Stewardship – Process		Selection
PR1	**The organisation identifies and manages its significant business risks. The organisation is risk aware rather than risk averse.**	
1.	Are the *Board*, *Management Team* and *Managers* involved in determining key risks and responses?	
2.	Does the organisation have a governance group to provide oversight of the risk management process reporting to the *Board* or *Management Team* that reviews risks at least quarterly?	
3.	Is there an up-to-date risk management strategy and policy approved by the *Board*, providing a consistent framework for the organisation including risk appetite and categories for assessing risk?	
4.	Do risk management arrangements include formal identification, recording, and assessment of risks?	
5.	Do risk management arrangements include properly resourced action plans with named, responsible individuals to mitigate and manage risks?	
6.	Do the risk registers link risks to organisational objectives?	
7.	Does the organisation have a designated manager responsible for ensuring that it manages its risks?	
8.	Do risk management arrangements include monitoring the development of risks and the effectiveness of management actions through indicators and early warning signs?	
9.	Are there arrangements to escalate risks to the *Board* and *Management Team* if the scale would have a corporate impact?	
10.	Does the *Leadership Team* regularly review the effectiveness of the organisation's risk management arrangements, including assurance from *internal audit*?	
11.	Do external auditors and inspectors comment favourably on the risk management arrangements of the organisation?	

Securing Stewardship – Process		Selection
PR2	**The organisation has arrangements in place to maintain an effective system of internal control.**	
1.	Does the organisation monitor and act to ensure compliance with relevant laws and regulations and that expenditure is lawful?	
2.	Does the organisation regularly review its internal control procedures and update them where necessary?	
3.	Does the organisation have structured arrangements in place to obtain the assurance needed to enable the Annual Governance Statement or Statement on Internal Control to be signed?	
4.	Does the *Leadership Team* take prompt action to remedy any breakdowns in internal control procedures?	
5.	Does the organisation monitor and act to ensure that its Financial Regulations or Standing Financial Instructions (including procurement) are used appropriately?	
6.	Does the organisation monitor and act to ensure compliance with its documented internal control procedures?	
7.	Does the *Audit Committee* receive and monitor the implementation of internal and external audit recommendations?	
8.	Was the annual audit letter free of weaknesses identified in the operation of internal controls?	
9.	Are *Board* members and staff aware of relevant codes of conduct and is compliance high?	
10.	Does the organisation have up to date procedures to prevent, detect, and investigate misconduct, fraud and corruption?	
11.	Do designated counter fraud and corruption staff follow formal procedures to investigate suspected fraud and corruption?	
12.	Do staff know what to do if they suspect misconduct, fraud or corruption?	
13.	Does the organisation regularly review the effectiveness of counter fraud and corruption arrangements?	

Securing Stewardship – Process		Selection
PR7	**The organisation's financial accounting and reporting meet professional and regulatory standards.**	
1.	Are accounts prepared, approved and published in accordance with regulatory timescales?	
2.	Did the accounts achieve financial balance and other statutory financial obligations?	
3.	Were statutory requirements, accounting policies, professional guidance and standards followed?	
4.	Are complex accounting issues eg Private Finance Initiative (PFI), International Financial Reporting Standards (IFRS), identified promptly and resolved within the necessary timescale?	
5.	Do staff follow guidance on final accounts closedown procedures, including timetables?	
6.	For the last audit, were all relevant working papers provided to the auditor at the start of the audit to the standard required by the auditor?	

7.	Was the quality of the accounts and working papers such that no unplanned audit time was required?	
8.	Did the accounts presented for audit contain only minor errors (i.e. no significant amendments arising from the audit so that they did not need to be re-presented for approval)?	
9.	Was an unqualified audit opinion given?	
10.	Was the auditor's annual letter free from concerns about the accounts process?	
11.	Was a post-external audit review undertaken to identify scope for improvement?	

Securing Stewardship – Process		**Selection**
PR8	**Budgets are robustly calculated.**	
1.	Does the organisation produce a *Medium-term Financial Plan*?	
2.	Is the *Medium-term Financial Plan* consistent with the organisation's aims and objectives?	
3.	Does the *Medium-term Financial* plan take account of local and national priorities, changing legal requirements, demographic trends and demand levels and national standards?	
4.	Does the organisation prepare its budget in accordance with its corporate objectives, strategies and *Medium-term Financial Plan*?	
5.	Does a risk assessment of material items of income and expenditure inform budget setting, and their reporting to the *Board* with financial implications, mitigating actions and contingency provisions?	
6.	Are fees, charges and concessions, including new options, related to policy objectives and reviewed annually?	
7.	Are revenue and capital budgets based on plans and projections about resource needs, pay and inflation, productivity levels, and income?	
8.	Are cost reductions, growth and savings options identified and reliably costed as part of the budget process?	
9.	Is the reporting of cashable efficiency gains reconciled with and reflected in the budget?	
10.	Are the revenue consequences of the capital programme and other expenditure commitments, including the consumption of capital (e.g. depreciation) reflected in revenue budgets?	
11.	Are forecast or actual budget variances and trends reflected in budget preparation?	
12.	Are managers fully involved in setting their budgets, working with *Finance staff*, so that they take ownership?	

Securing Stewardship – Process		Selection
PR9	**The organisation actively manages budgets, with monitoring and forecasting that is insightful, ensures 'no surprises' and leads to responsive action.**	
1.	Are financial and managerial responsibilities aligned, with revenue and capital budgets assigned to and owned by individual *Managers* within a formal scheme of budget delegation?	
2.	Are all budgets notified to *Managers* before the start of the financial year?	
3.	Do *Managers* know the organisation's overall in-year financial position against budget?	
4.	Are *Managers* held accountable for material deviations from budget?	
5.	Do *Managers* monitor budgets at least monthly and act promptly and effectively to respond to variances?	
6.	Do *Finance Staff* produce reports to the *Board* and the *Leadership Team* (at least quarterly unless circumstances require closer focus)) and *Managers* (monthly) that are relevant, accurate, timely, well presented and understandable?	
7.	Is monitoring predictive rather than backward looking and focused on large, high risk or volatile budgets?	
8.	Is monitoring related to operational activity indicators that are lead indicators of spend?	
9.	Does the organisation assess the progress of its capital projects and their impact on cash flow, capital financing, revenue accounts and balance sheet, at least quarterly?	
10.	Are reported variances analysed and used as a basis for taking corrective action?	
11.	Do reports link capital and revenue financial and operational information to give an overall picture of performance?	
12.	Does monitoring of investment schemes identify incidents of delay, project creep and cost overruns?	
13.	Does the organisation provide clear documentation, support and guidance, so that *Managers* who are budget holders understand their responsibilities and own their budgets?	
14.	Do *Finance staff* evaluate budget variances in terms of overall impact and risk for the organisation's financial position and standing?	
15.	Does the organisation have a clear policy on carry forward of year end variances, designed to help resources to be used to best effect?	
16.	Are spending trends and budgets projected over a rolling 12 month period ahead spanning financial years to identify emerging cost pressures and inform future planning?	

Securing Stewardship – Process		Selection
PR10	**The organisation maintains processes to ensure that information about key assets and liabilities in its balance sheet is a sound and current platform for management action.**	
1.	Are asset registers maintained and updated on a regular basis?	
2.	Are capital asset valuations reviewed and updated to reflect current asset values and lives, including depreciation, impairment, acquisitions and disposals?	
3.	Is there reliable information on the market value of investments, borrowings and other financings to allow the organisation to assess capital growth or capital reduction?	
4.	Does the organisation have reliable information about the value, number, age and status (e.g. whether being repaid by instalment, legally pursued, charged on assets etc) of all its debtors and assess the potential cost of write-offs?	
5.	Does the organisation have policies on expected levels for all its reserves and monitor these?	
6.	Does the organisation have an effective risk based system for quantifying and valuing its assets and liabilities, including stocks, especially where they are subject to loss, impairment, or market movements?	
7.	Does the organisation have a clear picture of assets and liabilities that are off balance sheet?	
8.	Does the organisation monitor the level of its provisions, so that they remain commensurate with potential liabilities?	
9.	Are events that may give rise to provisions (eg legal claims) monitored to identify whether an obligation has arisen?	
10.	Are contingent liabilities assessed and reported as they arise?	
11.	Are significant balance sheet movements reported to and considered by the *Board* (at least quarterly), highlighting exceptional or unusual impacts?	

Securing Stewardship – Process		Selection
PR11	**Collaborative arrangements to deliver services are accountable for their funding and service performance**.	
1.	Does the organisation have a complete picture of its formal delivery partnerships?	
2.	Are individual delivery partnerships evaluated to ensure they are linked clearly to policy objectives and organisational goals?	
3.	Is there a formal gateway process for evaluating and agreeing new arrangements?	
4.	Does the organisation differentiate its roles in delivery partnerships, in design, operational management and accountability for each, including separation of roles to avoid conflicts of interest e.g.: • 'sponsor', agreeing the business plan, and risk/reward arrangements, and providing financial and/or in kind resources • 'manager' leading on delivery of the business plan and accountable to sponsors for financial and operational performance • 'sub-contractor', taking delivery responsibility for a service and accountable to another 'manager' organisation • 'change manager', helping to set up new arrangements and migrate services to a new stand alone entity?	
5.	Do the organisation's Financial Regulations or Standing Financial Instructions cover its responsibilities in respect of delivery partnerships and collaborative arrangements?	
6.	Does the organisation make its delivery partners individually aware of their financial management and reporting responsibilities and obligations?	
7.	Are *Finance staff* and *Managers* clear about the different financial management, fiduciary and reporting responsibilities and obligations that apply to them in relation to the arms length service models and collaborative arrangements they are involved in, (eg as customer, provider or Board member of an arms length entity)?	
8. I	Is a comprehensive agreement in place for each of the organisation's delivery partnerships and collaborative arrangements (including any pooled budgets) that covers • aims and objectives; • ownership of and responsibility for any assets and liabilities • governance arrangements • funding arrangements; • accounting and financial reporting arrangements; • financial and performance monitoring arrangements;	

	• procurement arrangements; • risk management arrangements; • arrangements for reviewing, revising and agreeing the agreement • audit arrangements; • ending and dissolving the agreement?	
9.	Does the organisation review the financial standing and viability of key partners and any implications for the organisation (eg through any guarantees)?	
10.	Does the organisation actively monitor the financial and operational performance of key partners?	
11.	Is prompt corrective action taken where monitoring shows performance is not at expected levels?	
12.	Does the organisation regularly review each significant collaborative arrangement, including financial performance and value for money?	
13. ;	For all delivery partnerships (e.g. outsourcing and shared service arrangements), does the organisation have effective arrangements for • provision, access to and ownership of financial and performance data and information • variations: • performance bonuses and defaults • payments?	

Supporting Performance – Process		Selection
PR12	**The organisation's medium-term financial planning process underpins its strategic priorities.**	
1.	Does the *Medium-term Financial plan* represent a properly resourced, realistic programme of action over the medium term?	
2.	Does the *Medium-term Financial Plan* examine scenarios, risks and sensitivity analysis?	
3.	Does the organisation use formal processes to link the *Medium-term Financial plan* to other organisational plans (e.g. IT strategies, workforce strategy, asset management plans and service development plans)?	
4.	Does the organisation use formal processes to link the *Medium- term Financial plan* to the annual operational budgets?	
5.	Does the organisation's *Medium-term Financial Plan* reflect joint planning with partners and other stakeholders?	
6.	Does the organisation regularly review its *Medium-term Financial Plan*?	
7.	Is there a requirement in the Financial Regulations or Standing Financial Instructions to evaluate the financial implications and the long term affordability of new policy options, initiatives and major projects, involving *Finance staff* and using recognised option appraisal methods?	
8.	Is the long term affordability of new investment assessed?	
9.	Are there arrangements to review whether expected financial cost savings are realised?	
10.	Are there exit plans for time-limited funding streams?	
11.	Are targeted zero based budgeting exercises undertaken periodically?	
12.	Does the *Medium-term Financial Plan* consider options for new sources of income, new ways of reducing costs and of attracting additional sources of funding?	
13.	Does the organisation evaluate opportunities to invest to save (e.g. early intervention and prevention), identifying evidence, probability and targeting of impact, value for money and methods of realising future benefits and savings?	
14.	Does the organisation seek to diversify its funding streams, to reduce risk?	

Supporting Performance – Process		Selection
PR13	**The organisation systematically pursues opportunities to reduce costs and improve value for money in its operations..**	
1.	Does the organisation examine the relative cost and performance of services, including financial services, and test them against internal and external benchmarks to identify improvements?	
2.	Are cost reductions and efficiency routinely sought and realised as part of service reviews?	
3.	Do *Managers* focus on managing their costs and reducing inputs to achieve their goals rather than on using up their budgets?	
4.	Are targets for efficiency gains and spending reductions routinely agreed and set?	
5.	Does the organisation use national and local performance indicators to monitor performance (including financial performance)?	
6.	Are alternative delivery methods (e.g. outsourcing, collaboration and shared services) investigated and pursued?	
7.	Is cost reduction targeted at specific budgets or activities, following consideration of priorities, rather than as a standard percentage across all activities?”	
8.	Do *Managers* examine cost drivers of high spend areas to understand risks and options for cost reduction?	
9.	Does the organisation work across internal and organisational boundaries to achieve improvements (e.g. pooled resources, end to end process review)?	
10.	Does the organisation routinely undertake business process reviews and implement findings?	
11.	Does the organisation regularly examine its staffing structure, working practices and pay bill to improve overall productivity?	
12.	Does the organisation use technology to improve productivity, eg automating processes, implementing self-service or encouraging mobile working?	
13.	Is action taken to improve inefficient workflow processes (e.g. using lean thinking techniques, standardised processes, eliminating re-keying, reducing duplication)?	
14.	Does the organisation seek opportunities to capitalise on its skills and assets, and to spread overheads, by undertaking work for other public sector organisations where this improves value for money?	

Supporting Performance – Process		Selection
PR14	**The organisation systematically pursues opportunities for improved value for money and cost savings through its procurement and commissioning.**	
1.	Does the organisation have a corporate procurement strategy?	
2.	Does the organisation have procurement capacity to drive and realise the strategy?	
3.	Does the organisation develop its capacity by training professionally qualified and expert procurement staff?	
4.	Do *Managers* involved in procurement understand their responsibilities?	
5.	Does the organisation publish a forward procurement plan for suppliers?	
6.	Does the organisation participate in framework contracts, joint procurement or consortia to exploit economies of scale and market influence?	
7.	Does the organisation evaluate appropriate procurement strategies, eg lease, buy or make?	
8.	Does the corporate procurement strategy incorporate gateway reviews for high risk projects?	
9.	Does the organisation ensure most purchasing is under formal contract and monitor off-contract purchasing?	
10.	Does the organisation have effective and adequately resourced contract monitoring and reporting arrangements in place?	
11.	Does the organisation ensure value for money during the life of a contract through active contract management, creating opportunities for improved methods during long life contracts?	
12.	Does the organisation seek value for money through encouraging competition and contestability, accessing wider markets, packaging contracts, supply chain management and developing supplier relationships?	
13.	Does the organisation research and gather market intelligence to develop creative solutions with potential suppliers?	
14.	Does the organisation work with others to stimulate and develop markets where they are weak?	
15.	Is procurement used to meet the strategic objectives of the organisation, including impacts on the environment, workforce training, the local economy or community engagement?	
16.	Is e-procurement (e.g. purchase to pay and e-tendering) used as a means of reducing administration costs and/or increasing competition?	
17.	Are e-auctions used as a method of increasing value for money?	
18.	Does the organisation award contracts through assessing whole life costs and benefits using the appropriate investment appraisal technique?	

Supporting Performance – Process		Selection
PR15	**The organisation pursues value for money through active management of its fixed assets.**	
1.	Does the *Leadership Team* actively review asset utilisation and opportunities for more intensive use and estates rationalisation?	
2.	Is there an asset management plan that reviews the condition, sufficiency and suitability of assets in the light of business needs, and ambitions of the *Corporate Business Plan?*	
3.	Does the *Medium-term Financial Plan* include targets for the value of asset disposals?”	
4.	Are asset sales determined by planned rationalisation rather than as a quick fix funding stream?	
5.	Are intangible assets, such as intellectual property, actively managed?	
6.	Is stock management reviewed to optimise delivery times versus holding costs?	

Estimation of Revenue Impact of Additional Spend on Edinburgh Trams Project

APPENDIX 4

	£m		Basis / Source / Comments
A. Additional Capital Expenditure and Increase in Borrowing Requirement			
Final capital cost of the project	776.662		Per tabled evidence
Original Budget	545.000		As cited in the report
Capital Expenditure over and above original budget (to be funded from borrowing)	231.662		£231m also cited as the additional spend in CEC Annual Accounts 2011/12 for example pages 10, 101
shortfall in developer contributions resulting in increased borrowing	15.500		
Total increase in borrowing over and above the original plan	**247.162**		
B. Borrowing cost for the Additional Expenditure			
Revenue impact of borrowing for the additional amount estimated as			
A) Loans Fund Charges (principal and interest) for increased costs	13.400	per annum	NOTE: The calculation is based on the understanding that CEC was fully responsible for funding 100% of the additional spend and that borrowing was utilised for this purpose, on the general terms indicated in the note above, with the full impact of the borrowing being borne by the Council taxpayer on the basis that no additional funding was provided by the Scottish Government.
B) Loans Fund Charges (principal and interest) re developer contributions shortfall	0.900	per annum	
	14.300		
for	30	years	
Total cost of funding the additional spend to be charged to the General Fund	**429.000**		

C. Split between Interest and Capital (Principal) Repayment

Therefore the effective interest cost of servicing / financing the additional **borrowing**	**197.338**		calculation : total charges to revenue less the known increase in the principal element borrowed
period of financing of the additional **borrowing**	30	years	per above
Therefore average annual interest cost per year	**6.578**		calculation - straight average per year NOTE: The actual profiling of the interest charges is unlikely to be 'straight line' since the council is likely to have used an 'annuity scheduling' approach. This estimation however is seeking to identify the AVERAGE impact per annum on a Council Tax Band D taxpayer.
Repayment of borrowing (principal element charged to General Fund)	**247.162**		per above - total additional borrowing arising
period of financing of the additional spend	30	years	per above
Therefore average annual repayment of principal over 30 years	**8.239**		

D. Impact per Band D Equivalent

The council tax base for 2011/12	196,435	Band D equivalents	per CEC Annual Accounts 2011/12 page 126

NOTE: The number of Band D equivalents used is from 11/12 on the basis that this is when the decision to incur the additional spend was incurred. The number of Band D equivalents is subject to annual change (eg 192,783 in 2008/09 to over 205,000 in 2015/16). A growth in Band D equivalents would tend to decrease the average cost per Band D taxpayer. In addition it should be noted that the changes to the higher level Band multipliers implemented by the Scottish Government for 2017/18 will also affect the revenue impact on the actual Council Tax paid by different Council Tax payers.

Therefore

average annual interest per band D equivalent (over the 30 years)	£ 33.49	£ per Band D	calculation
average annual repayment of principal per band D equivalent (over the 30 years)	£ 41.94	£ per Band D	calculation
Total cost per Band D equivalent (as at 11/12) per annum for 30 years	**£ 75.43**	**£ per Band D**	
Further analysis			
Additional Spend: average annual interest per band D equivalent (over the 30 years)	£ 31.39		Annual impact on Band Council Tax re Additional Capital Spend
Additional Spend: average annual repayment of principal per band D equivalent (over the 30 years)	£ 39.31		Annual impact on Band Council Tax re Additional Capital Spend
Additional Spend: average annual charges (principal & interest)	**£ 70.70**		
Dev. Contributions Shortfall: average annual interest per band D equivalent (over the 30 years)	£ 2.10		Annual impact on Band Council Tax re Shortfall in Developer Contributions
Dev. Contributions Shortfall average annual repayment of principal per band D equivalent (over the 30 years)	£ 2.63		Annual impact on Band Council Tax re Shortfall in Developer Contributions

	£ 4.73

E. Sense Check

Per annum impact on the council of spending an additional £231m as stated by CEC	15.000	per annum	CEC Annual Accounts 2011/12 page 37 note 4 (stated above)
Number of Band D equivalents (in 2011/12)	196,435	Band D equivalents	per CEC Annual Accounts 2011/12 page 126
therefore CEC estimate of impact of the additional spend per Band D	£ 76.36	£ per Band D	Calculation

APPENDIX 5

The Chartered Institute of Public Finance & Accountancy

the role of the chief financial officer

In public service organisations

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CIPFA Statement on the role of the Chief Financial Officer in public service organisations

The Chief Financial Officer in a public service organisation:

1 is a key member of the Leadership Team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest;

2 must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy; and

3 must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

To deliver these responsibilities the Chief Financial Officer:

4 must lead and direct a finance function that is resourced to be fit for purpose; and

5 must be professionally qualified and suitably experienced.

Contents

\ foreword

The Chief Financial Officer (CFO) occupies a critical position in any organisation, holding the financial reins of the business and ensuring that resources are used wisely to secure positive results. While the global financial crisis and economic downturn have made these tasks even more challenging, they have also underlined the fundamental importance of the role.

Achieving value for money and securing stewardship are key components of the CFO's role in public service organisations. But what are the other duties and responsibilities that sit alongside? What aspects of the organisation's activities and business must the CFO be able to contribute to and influence to be fully effective in the role? What are the qualities, skills and knowledge that the CFO must aspire to in order to meet the organisation's needs?

The list of the other potential roles that the CFO might take on is diverse. Different organisations inevitably make different choices. This makes it critically important to be clear about the absolutely essential ingredients that must be in the mix. Without clarity about the fundamental components of the core job, we run the risk that CFOs cannot reach all of the key levers to perform their core financial duties effectively, or address challenges when they arise.

CIPFA has developed this Statement on the Role of the CFO in Public Service Organisations in order to help bring clarity to this complex picture. It sets out an overarching principles-based framework that is intended to apply to all public service organisations and their CFOs, irrespective of where they work. The Statement draws on established good practice and regulatory requirements, as well as the requirements of CIPFA and other professional accountancy bodies' codes of ethics and professional standards.

The Statement covers ground that is critically important for the good governance of all public service organisations. For that reason, our aim is to encourage public service-wide use of the Statement as the benchmark for organisational arrangements. We recommend that all organisations should report publicly on their arrangements, particularly where these do not conform to the governance requirements in the Statement. Providing this information openly on a 'comply or explain' basis will help to assure stakeholders and the public that the organisation has given proper consideration to these vitally important aspects of its governance arrangements.

The Statement is also intended to support individual finance professionals. It articulates the core responsibilities of the CFO, as well as the personal skills and professional standards that are crucial to success in the role. In this way it provides an important source of reference for personal development, both for current and aspiring CFOs. We therefore hope that finance professionals at all stages of their careers will find it useful.

Jon Pittam
Chair
CIPFA Role of the Public Services Director of Finance Panel

Steve Freer
Chief Executive
CIPFA

definitions used throughout the document

The public services have a variety of organisational structures and governance arrangements. Some include elected representatives, while others are wholly appointed. The following terms are used throughout the Statement in a generic sense. The Statement and the supporting guideline and requirements need to be read in the context of these. Terms in use in different parts of the public services can be substituted for the generic terms used here.

Chief Financial Officer (CFO)

The organisation's most senior executive role charged with leading and directing financial strategy and operations.

Leadership Team

Comprises the Board and Management Team.

Board

The group of people charged with setting the strategic direction for the organisation and responsible for its achievement.

Management Team

The group of executive staff comprising the senior management charged with the execution of strategy.

Chief Executive

The most senior executive role in the organisation.

Managers

The staff responsible for the achievement of the organisation's purpose through services/ businesses and delivery to its clients/customers.

Finance Function

The staff with a prime responsibility for financial matters, located either in a central department or within business/service areas. Some functions may be outsourced.

Governance[1]

The arrangements in place to ensure that an organisation fulfils its overall purpose, achieves its intended outcomes for citizens and service users, and operates in an economical, effective, efficient and ethical manner.

Financial Management[2]

The system by which the financial aspects of a public service organisation's business are directed, controlled and influenced, to support the delivery of the organisation's goals.

Audit Committee

The governance group charged with independent assurance of the adequacy of the risk management framework, the internal control environment and the integrity of financial reporting.

Internal Audit

An assurance function that provides an independent and objective opinion to the organisation on the control environment, by evaluating its effectiveness in achieving the organisation's objectives.

Head of Profession

The leading professionally qualified accountant charged with promoting professional standards within the organisation.

Annual Governance Report

The mechanism by which an organisation publicly reports on its governance arrangements each year.

Public Service Organisation

One or more legal bodies managed as a coherent operational entity with the primary objective of providing goods or services that deliver social benefits for civic society, are not privately owned, and receive public and/or charitable funding.

[1] *The Good Governance Standard for Public Services 2004*

[2] *CIPFA FM Model 2009*

introducing the CIPFA Statement

The public service context

Citizen, service user, and taxpayer: all of us occupy one or other of these roles at different times. We all have different priorities and emphases, but our common ground is that we expect high standards of service, on an improving trajectory, within affordable tax levels and that we demand exemplary standards of behaviour where public money is spent.

These public demands have generated a succession of initiatives, from governments and other institutions, aimed at extracting maximum value from public money. These have variously emphasised sustainability, efficiency and the productive use of resources. They have often been reinforced by inspection and assurance regimes, the intensity of which has ebbed and flowed over time. However the enduring task of the public services remains the resolution of the tension between ever increasing public expectations and increasingly limited funding.

The public services also face frequent structural changes. The prevalence of complex social issues that require a coordinated response is increasingly bringing together organisations with different structures and objectives in various forms of partnership. Expectations of contestability and competition as drivers of value for money are also blurring the boundaries between the public and private sectors. This has increased the variety of governance arrangements, even among similar types of bodies.

Good Governance and strong Public Financial Management

The changing political environment within which decisions are taken and services delivered creates a web of stakeholders whose interests and influences must be acknowledged, understood, managed and balanced. Stakeholders all expect the organisation to report on their business outcomes in different ways.

The focus on ambition and organisational capacity to deliver good public services within a complex environment has strengthened expectations of effective governance. Good governance in a public service organisation requires a focus on the organisation's purpose and its intended social outcomes. It also carries a specific obligation to citizens, taxpayers and service users to make best use of resources and ensure value for money.

The role of the CFO is a fundamental building block of good corporate governance. The two critical aspects of the role are stewardship and probity in the use of resources; and performance, extracting the most value from the use of those resources.

The key role played by the CFO

The CFO, as the organisation's most senior executive role charged with leading and directing financial strategy and operations, occupies a pivotal role, both for external stakeholders and within the Leadership Team. CFOs everywhere have a responsibility to ensure that their organisations control and manage money well, and that strategic planning and decision making are supported by sound analysis. In the public service context, CFOs must also meet the demands of openness and accountability in decision making, balance competition for limited resources across a range of worthwhile objectives, deliver value for money and safeguard taxpayers' money. Delivering these requires a range of personal qualities, as well as support from both the finance function and the organisation as a whole.

It is these expectations, combined with the personal qualities and leadership skills needed for them to be met, that have shaped the CIPFA Statement on the Role of the CFO in Public Service Organisations.

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using the CIPFA Statement

Statement approach and structure

The Statement sets out the five principles that define the core activities and behaviours that belong to the role of the CFO in public service organisations and the organisational arrangements needed to support them. Successful implementation of each of the principles requires the right ingredients in terms of:

- The Organisation;
- The Role: and
- The Individual.

For each principle the Statement sets out the governance arrangements required within an organisation to ensure that CFOs are able to operate effectively and perform their core duties. The Statement also sets out the core responsibilities of the CFO role within the organisation. Many of the day-to-day responsibilities may in practice be delegated or even outsourced, but the CFO should maintain oversight and control.

Summaries of personal skills and professional standards then detail the leadership skills and technical expertise organisations can expect from their CFO. These include the key requirements of CIPFA and the other professional accountancy bodies' codes of ethics and professional standards to which the CFO as a qualified professional is bound. The personal skills described have been aligned with the most appropriate principle, but in many cases can support other principles as well.

Demonstrating compliance

The Statement supports CIPFA's work to strengthen governance and financial management across the public services. It is intended to allow the Leadership Team of a public service organisation, whether elected, executive or non-executive, to benchmark its existing arrangements against a defined framework.

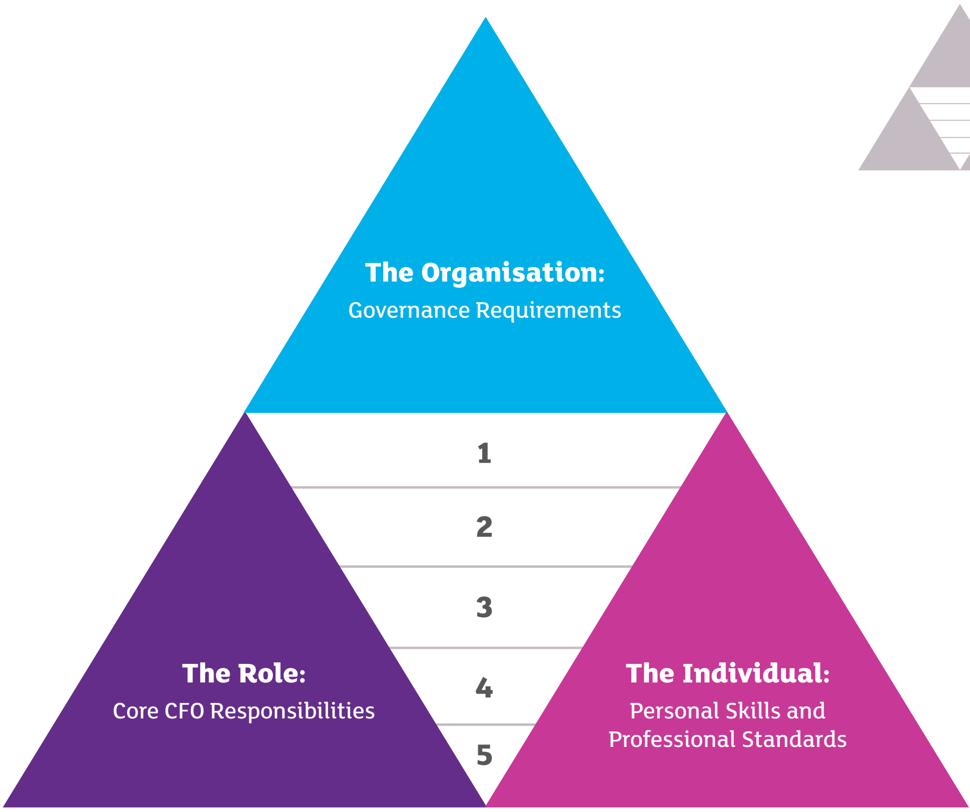
Public service organisations operate within a variety of legal and regulatory structures, and there is a huge range in size and scope of services delivered. The Statement therefore adopts a 'substance over form' approach, focussing on the principles that capture the essential characteristics of the CFO role in any public service organisation.

CIPFA recommends that organisations should use the Statement as the framework to benchmark their existing arrangements, and that they should report publically on compliance to demonstrate their commitment to good practice in both governance and financial management. CIPFA also recommends that organisations should report publicly where their arrangements do not conform with to the compliance framework in the Statement, explaining the reason for this, and how they deliver the same impact as those in the Statement.

Status of the Statement

The Statement does not have the status of a CIPFA Code. Nor does it replace the sector-specific guidance or the codes and professional standards that underpin accountancy bodies' competency and disciplinary frameworks. The aim is that regulators should draw on the Statement when reviewing their own guidance.

On a personal basis, the Statement should help guide both current and aspiring CFOs, by providing a summary of the core responsibilities entailed in the CFO role as well as the personal skills and professional standards necessary to succeed. It should therefore provide a focus for finance professionals' own personal development at all stages of their careers.



Cipfa Statement on the role of the Chief Financial Officer (CFO) in public service organisations

The CFO in a public service organisation:

1 is a key member of the Leadership Team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest;

2 must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy; and

3 must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

To deliver these responsibilities the CFO:

4 must lead and direct a finance function that is resourced to be fit for purpose; and

5 must be professionally qualified and suitably experienced.

\ principle 1

The CFO in a public service organisation is a key member of the Leadership Team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest.

Key member of the Leadership Team

The Leadership Team in public services organisations takes many forms, with different mixes of executive and non–executive members, as well as sometimes including elected representatives. Collectively the Leadership Team are responsible for setting the strategic direction for the organisation, its implementation and the delivery of public services. In recognition of the centrality of financial issues to organisational success it is UK government policy that all government departments should have a professional CFO reporting directly to the permanent secretary with a seat on the departmental board, with a status equivalent to other Board members. HM Treasury recommends 'It is good practice for all other public sector organisations to do the same, and to operate the same standards'.[3]

CIPFA supports the Treasury's recommendation. The governance requirements in the Statement are that the CFO should be professionally qualified, report directly to the Chief Executive and be a member of the Leadership Team, with a status at least equivalent to other members. The Statement requires that if different organisational arrangements are adopted the reasons should be explained publicly in the organisation's Annual Governance Report, together with how these deliver the same impact.

Developing and implementing organisational strategy

All public service organisations face competition for limited public funds. However they differ in the level of control they have over their total resource envelope. Many will have allocated cash limits, while others have tax raising powers. All will be concerned to examine opportunities, with suitable assessment of legal powers and risk, for building income streams, whether through attracting external grants, charging for services, or commercial activity.

Strategic planning needs to be based on an understanding of the external political landscape, the organisation's demand and cost drivers, and the need to manage and fund longer term commitments on a sustainable basis. Finance translates ambitions and goals across the organisation into a common language, so the CFO must share in the strategy development and implementation responsibilities of the Leadership Team. Where relevant these include supporting elected representatives under the proper governance arrangements. The CFO must also ensure the members of the Leadership Team have the financial capabilities necessary to perform their own roles effectively.

The CFO must encourage continuous improvement and development to enable the organisation to deliver at the highest levels As well as having the fundamental concern for probity and control, the CFO must be proactive in managing change and risk, be focussed on outcomes, and help to resource the organisation's plans for change and development in the public services it provides. As a key member of the Leadership Team, the CFO must also behave in ways that are consistent with the organisation's agreed values and objectives.

Helping resource and deliver organisational objectives

There is a growing trend for CFOs to hold a range of different responsibilities beyond finance, including managing other services or leading change programmes. Whilst these can develop the individual as a corporate manager, organisations must not let the CFO's core financial responsibilities be compromised through creating too wide a portfolio. Dilution and/or overload in the role of the CFO can result in poor financial outcomes for the organisation. Setting out the core CFO responsibilities in this Statement is intended to allow public service organisations and their CFOs to assess their job descriptions to ensure that their core finance responsibilities can be properly performed.

Public service organisations also need to engage with partners through a range of collaborative or commissioned relationships in order to realise their goals. Partnership working and the focus on community outcomes mean that the CFO needs to understand the financial risks and potential liabilities that may impact on the organisation and have appropriate involvement in partnerships' business decisions. The CFO must therefore work to develop strong and constructive working relationships with key decision makers in partner organisations.

Delivering the organisation's strategic objectives sustainably and in the public interest

Public service organisations have a corporate responsibility to operate within available resources and to remain financially sound over the short, medium and longer term. Maximising public value involves an appreciation of user needs, expectations and preferences, and the planning process must allow for their involvement and influence.

The internal process to determine priorities often then needs to grapple with service rationing and difficult trade-offs between different groups of service users, as well as between present and future benefits. The overarching long term need to match financial resources to the organisation's purposes and policies, within constraints of affordability, taken with the responsibility to citizens and taxpayers for financial stewardship, mean that the CFO must contribute actively to cross organisational issues and to corporate decision making.

Public finance is complex and highly regulated, and the CFO must contribute expert technical advice and interpretation. CFOs must act in the public interest, even if necessary against a perceived organisational interest. In some types of public service organisation this professional obligation is given statutory backing, and a fiduciary duty is established in case law. As holders of the 'red card', the CFO must exercise a professional responsibility to intervene in spending plans in order to maintain the balance of resources so that the organisation remains a going concern. To ensure that the necessary corrective action is implemented, the CFO must have direct access to the Chief Executive, other Leadership Team members, the Audit Committee and also to external audit.

[3] *HM Treasury 'Managing Public Money' Annex 4.1. 2007*

Governance requirements — Principle 1

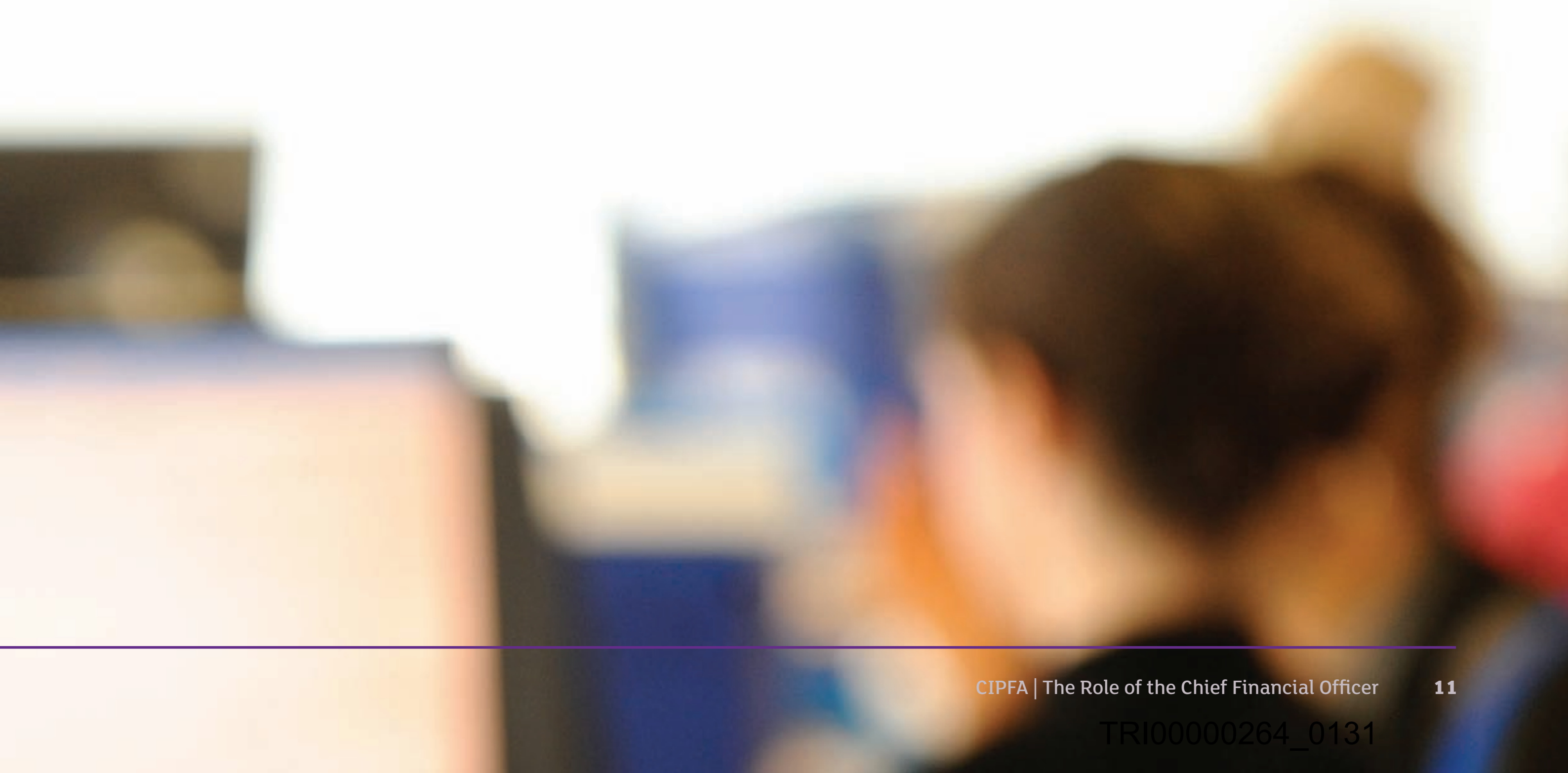
- Set out a clear statement of the respective roles and responsibilities of the Leadership Team and its members individually.
- Ensure that the CFO reports directly to the Chief Executive and is a member of the Leadership Team with a status at least equivalent to other members.
- If different organisational arrangements are adopted, explain the reasons publicly, together with how these deliver the same impact.
- Determine a scheme of delegation and reserve powers, including a formal schedule of those matters specifically reserved for collective decisions by the Board, and ensure that it is monitored and updated.
- Ensure that organisation's governance arrangements allow the CFO:
  - to bring influence to bear on all material business decisions; and
  - direct access to the Chief Executive, other Leadership Team members, the Audit Committee and external audit.
- Review the scope of the CFO's other management responsibilities to ensure financial matters are not compromised.
- Assess the financial skills required by members of the Leadership Team and commit to develop those skills to enable their roles to be carried out effectively.

Core CFO responsibilities — Principle 1

- Contributing to the effective leadership of the organisation, maintaining focus on its purpose and vision through rigorous analysis and challenge.
- Contributing to the effective corporate management of the organisation, including strategy implementation, cross organisational issues, integrated business and resource planning, risk management and performance management.
- Supporting the effective governance of the organisation through development of
  - corporate governance arrangements, risk management and reporting framework; and
  - corporate decision making arrangements.
- Leading or promoting change programmes within the organisation.
- Leading development of a medium term financial strategy and the annual budgeting process to ensure financial balance and a monitoring process to ensure its delivery.
- Ensuring the medium term financial strategy reflects joint planning with partners and other stakeholders.

Personal skills and professional standards — Principle 1

- Role model, energetic, determined, positive, robust and resilient leadership, able to inspire confidence and respect, and exemplify high standards of conduct.
- Adopt a flexible leadership style, able to move through visioning to implementation and collaboration/consultation to challenge as appropriate.
- Build robust relationships both internally and externally.
- Work effectively with other Leadership Team members with political awareness and sensitivity.
- Support collective ownership of strategy, risks and delivery.
- Address and deal effectively with difficult situations.
- Implement best practice in change management and leadership.
- Balance conflicting pressures and needs, including short and longer term trade-offs.
- Demonstrate strong commitment to innovation and performance improvement.
- Manage a broad portfolio of services to meet the needs of diverse communities.
- Maintain an appropriate balance between the deeper financial aspects of the CFO role and the need to develop and retain a broader focus on the environment and stakeholder expectations and needs.
- Comply with the IFAC Code of Ethics for Professional Accountants, as implemented by local regulations and accountancy bodies, as well as other ethical standards that are applicable to them by reason of their professional status. The fundamental principles set out in the Code are integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour. Impartiality is a further fundamental requirement of those operating in the public services.



\ principle 2

The CFO in a public service organisation must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's overall financial strategy.

Responsibility for financial strategy

No organisation can achieve its goals effectively without proper structures for allocating and optimising the use of resources. The centrality of finance means the CFO must play the lead role in advising and supporting the Leadership Team in turning policy aspirations into reality by aligning financial planning with the vision and strategic objectives for the organisation.

Within the overall corporate governance and management structure, the CFO has direct responsibility for leading development and implementation of the financial strategy necessary to deliver the organisation's strategic objectives sustainably. The CFO must therefore work closely with decision makers to establish a medium to long term strategy that ensures the financial sustainability of the organisation.

The CFO must also develop and manage resource allocation models to optimise service outputs and community benefits within funding constraints and any tax raising limits. In implementing these models, the CFO must ensure that the financial and risk implications of policy initiatives are analysed and appropriately addressed. Models must encompass capital investment programmes and annual operations, as well as financial targets and benchmarks. They must also take into account future commitments, resources available and the desirable levels of reserves, to ensure that the organisation's finances remain sustainable.

Influencing decision making

Public service organisations must be rigorous in their decision making, be explicit about the reasons for their decisions and record the supporting information and expected impact. This requires the CFO to be actively involved in, and able to bring influence to bear on all material business decisions whenever and wherever they are taken.

The CFO must be able to advise the Leadership Team directly, in order to discharge responsibilities in relation to the organisation's financial health and long term viability. The CFO must therefore be a persuasive and confident communicator with the status and credibility to challenge others, and influence material business decisions. The CFO's advice and reports to the Leadership Team must be clear, concise, relevant and timely, highlighting issues that the team needs to be aware of, and options for action.

The CFO must also work to develop strong and constructive working relationships with both the executive and non executive members of the organisation's leadership, creating mutual respect and effective communication. Providing information and advice to elected officials as a public servant will call on an understanding of ethics, the wider public interest, and diplomacy.

Financial information for decision makers

At all levels in the organisation those taking decisions must be presented with relevant, objective and reliable financial analysis and advice, clearly setting out the financial implications and risks.

The CFO has an important role in ensuring necessary financial information and advice is provided to the Leadership Team and decision makers at all levels across the organisation. Meaningful financial analysis and robust and impartial interpretation is a key component in performance management, asset management, investment appraisal, risk management and control.

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Governance requirements — Principle 2

- Establish a medium term business and financial planning process to deliver the organisation's strategic objectives, including:
  - a medium term financial strategy to ensure sustainable finances;
  - a robust annual budget process that ensures financial balance; and
  - a monitoring process that enables this to be delivered.
- Ensure that professional advice on matters that have financial implications is available and recorded well in advance of decision making and used appropriately.
- Ensure that those making decisions are provided with information that is fit for the purpose – relevant, timely and giving clear explanations of financial issues and their implications.

Core CFO responsibilities — Principle 2

Responsibility for financial strategy

- Agreeing the financial framework with sponsoring organisations and planning delivery against the defined strategic and operational criteria.
- Maintaining a long term financial strategy to underpin the organisation's financial viability within the agreed performance framework.
- Implementing financial management policies to underpin sustainable long-term financial health and reviewing performance against them.
- Appraising and advising on commercial opportunities and financial targets.
- Developing and maintaining an effective resource allocation model to deliver business priorities.
- Leading on asset and balance sheet management.
- Co-ordinating the planning and budgeting processes.

Influencing decision making

- Ensuring that opportunities and risks are fully considered and decisions are aligned with the overall financial strategy.
- Providing professional advice and objective financial analysis enabling decision makers to take timely and informed business decisions.
- Ensuring that the organisation's capital projects are chosen after appropriate value for money analysis and evaluation using relevant professional guidance.
- Checking, at an early stage, that innovative financial approaches comply with regulatory requirements.

Financial information for decision makers

- Monitoring and reporting on financial performance that is linked to related performance information and strategic objectives that identifies any necessary corrective decisions.
- Preparing timely management accounts.
- Ensuring the reporting envelope reflects partnerships and other arrangements to give an overall picture.

Personal skills and professional standards — Principle 2

- Implement appropriate management, business and strategic planning techniques.
- Link financial strategy and overall strategy.
- Demonstrate a willingness to take and stick to difficult decisions – even under pressure.
- Take ownership of relevant financial and business risks.
- Network effectively within the organisation to ensure awareness of all material business decisions to which CFO input may be necessary.
- Role model persuasive and concise communication with a wide range of audiences internally and externally.
- Provide clear, authoritative and impartial professional advice and objective financial analysis and interpretation of complex situations.
- Apply relevant statutory, regulatory and professional standards both personal and organisational.
- Demonstrate a strong desire to innovate and add value.
- Challenge effectively, and give and receive constructive feedback.
- Operate with sensitivity in a political environment.

\ principle 3

The CFO in a public service organisation must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently, and effectively.

Promotion and delivery of good financial management

Good financial management is fundamental to establishing confidence in the public services and good relationships with the taxpayer and other funders. The Leadership Team collectively needs to set the tone that financial management is core to achieving strategic aims, and to demonstrate that public money is used well. Nevertheless it is the CFO who must take the lead in establishing a strong framework for implementing and maintaining good financial management across the organisation. The CFO will be instrumental in assessing the existing organisational style of financial management and the improvements needed to ensure it aligns with the organisation's strategic direction.

Financial management is the business of the whole organisation. When the Leadership Team, managers and the finance function all fulfil their financial management responsibilities successfully, they collectively create the financially literate and adept organisation. The CFO must actively promote financial literacy throughout the organisation, so that the Leadership Team and managers can discharge their financial management responsibilities, alongside their wider responsibilities in relation to risk and performance management.

Value for money

The CFO has a key role to play in balancing control and compliance with value creation and performance.[4] Better value for money releases resources that can be recycled into higher priorities, without increasing taxation. Helping to secure positive social outcomes within affordable funding therefore lies at the heart of the CFO's role in the public service organisation.

With the foundations in place, good financial management will focus on stretching limited resources to maximise value for the public service. Value for money (economy, efficiency and effectiveness) should be the concern of all managers, but the CFO will need to take the lead in coordinating and facilitating a culture of efficiency and value for money. This will involve approaches and techniques such as

- Enabling the organisation to measure value for money, and making sure that it has the information to review value for money and performance effectively;
- Advising on appropriate strategies for managing assets and stretching utilisation, and the productive use of other resources;
- Providing leadership in using and developing efficiency tools and techniques, including benchmarking, IT, shared services, process analysis and cost management, collaborating with others where this is more efficient, effective or economical; and
- Ensuring the rigorous financial appraisal and oversight of change programmes, income generation proposals and investment projects.

Safeguarding public money

The CFO must lead the implementation and maintenance of a framework of financial controls and procedures for managing financial risks, and must determine accounting processes and oversee financial management procedures that enable the organisation to budget and manage within its overall resources. At the most fundamental level this means ensuring robust systems of risk management and internal control, that financial control is exercised consistently, and that the organisation implements appropriate measures to protect its assets from fraud and loss.

The CFO also has a specific role with regard to stewardship. This includes ensuring that the governance structures codify financial control, internal control, risk management and assurance, as well as defining a framework of financial accountabilities and reporting.

Assurance and scrutiny

Accountability for public expenditure is a core requirement for public service organisations. They are held accountable by intermediary stakeholders, such as scrutiny groups, service inspectorates and external auditors, and by primary stakeholders: the citizens, service users, funders and taxpayers.

Managing information flows is a key component of the CFO's role as an ambassador for the organisation on financial matters and in building relationships with stakeholders. The CFO must also provide information and advice to those who officially scrutinise and review the organisation; funders, regulators, and external audit, and any group which exercises scrutiny internally. The community, taxpayers and the press also expect information.

Internal audit is an important independent internal scrutiny activity. The CFO must support the organisation's internal audit arrangements, whether the function reports directly to the CFO or the Chief Executive, and ensure that the Audit Committee receives the necessary advice and information, so that both functions can operate effectively.

Public service providers face a variety of regulatory requirements and standards for external financial reporting, while measures of value are expressed both as financial and as non-financial performance targets. The role of the CFO in external reporting is to meet the reporting requirements relevant to the organisation and to apply professional good practice, conscious of the needs of users. External financial reporting must be of good quality, supported by analysis and documentation and should receive an unqualified audit opinion. This will be facilitated if the CFO maintains a constructive professional relationship with external auditors and inspectors.

[4] *IFAC – PAIB 'The Roles and Domain of the Professional Accountant in Business' 2005*

Governance requirements	Principle 3

- Make the CFO responsible for ensuring that appropriate advice is given on all financial matters, for keeping financial records and accounts, and for maintaining an effective system of financial control.
- Ensure that systems and processes for financial administration, financial control and protection of the organisation's resources and assets are designed in conformity with appropriate ethical standards and monitor their continuing effectiveness in practice.
- Address the organisation's arrangements for financial and internal control and for managing risk in Annual Governance Reports.
- Publish annual accounts on a timely basis to communicate the organisation's activities and achievements, its financial position and performance.
- Maintain and resource an effective internal audit function.
- Develop and maintain an effective Audit Committee.
- Ensure that the organisation makes best use of resources and that taxpayers and/or service users receive value for money.
- Embed financial competencies in person specifications and appraisals.
- Assess the financial skills required by managers and commit to develop those skills to enable their roles to be carried out effectively.

Core CFO responsibilities — Principle 3

Promotion of financial management

- Assessing the organisation's financial management style and the improvements needed to ensure it aligns with the organisation's strategic direction.
- Actively promoting financial literacy throughout the organisation.

Value for money

- Challenging and supporting decision makers, especially on affordability and value for money, by ensuring policy and operational proposals with financial implications are signed off by the finance function.
- Developing and maintaining appropriate asset management and procurement strategies.
- Managing long term commercial contract value.

Safeguarding public money

- Applying strong internal controls in all areas of financial management, risk management and asset control.
- Establishing budgets, financial targets and performance indicators to help assess delivery.
- Implementing effective systems of internal control that include standing financial instructions, operating manuals, and compliance with codes of practice to secure probity.
- Ensuring that delegated financial authorities are respected.
- Promoting arrangements to identify and manage key business risks, including safeguarding assets, risk mitigation and insurance.
- Overseeing of capital projects and post completion reviews.
- Applying discipline in financial management, including managing cash and banking, treasury management, debt and cash flow, with appropriate segregation of duties.
- Implementing appropriate measures to prevent and detect fraud and corruption.
- Establishing proportionate business continuity arrangements for financial processes and information.
- Ensuring that any partnership arrangements are underpinned by clear and well documented internal controls.

Assurance and scrutiny

- Reporting performance of both the organisation and its partnerships to the board and other parties as required.
- Supporting and advising the Audit Committee and relevant scrutiny groups.
- Preparing published budgets, annual accounts and consolidation data for government-level consolidated accounts.
- Liaising with the external auditor.

Personal skills and professional standards **Principle 3**

- Generate 'buy-in' to, and support delivery of, good financial management across the organisation.
- Develop and sustain partnerships, and engage effectively in collaboration.
- Deploy effective facilitation and meeting skills.
- Build and demonstrate commitment to continuous improvement and innovative, but risk-aware, solutions.
- Place stewardship and probity as the bedrock for management of the organisation's finances.

\ principle 4

The CFO in a public service organisation must lead and direct a finance function that is resourced to be fit for purpose.

Meeting the finance needs of the business

The organisation of finance functions is changing rapidly. Traditionally they have been centralised services, but increasingly they include devolved finance teams in business areas. Arrangements may also now include outsourced functions, or services shared between organisations.

Whatever the structure, a strong customer focus both externally and internally must be a key feature of the way the finance function does business. It must support the organisation's broader development agenda, by appraising investment options and change programmes and contributing creative financial solutions within an effective risk management framework.

The finance function must also have a firm grasp of the organisation's financial position and performance. The CFO must ensure that there is sufficient depth of financial expertise, supported by effective systems, to discharge this responsibility and challenge those responsible for the organisation's activities to account for their financial performance. The resources available must be proportionate to the complexity of the financial environment.

Appropriately developed finance skills

The CFO must promote financial literacy throughout the organisation, including championing training and development of relevant skills at all levels. However the CFO has a particular responsibility for learning and development amongst finance staff in order to ensure that both current and likely future finance skill needs are addressed. This will include identifying the competencies needed by the finance function, including specialist skills, and ensuring it can access the skills and experience to exercise stewardship of public finances, develop financial performance and contribute effectively to new organisational directions and innovation.

The CFO must ensure that the Head of Profession role for accountants and finance specialists organisation-wide is properly discharged in order to ensure compliance with regulatory and professional standards. Exercising leadership on financial matters in a devolved environment will require a documented line of professional accountability to the CFO, where this is not a direct line management relationship.

Governance requirements — Principle 4

- Provide the finance function with the resources, expertise and systems necessary to perform its role effectively.
- Ensure there is a line of professional accountability to the CFO for finance staff throughout the organisation.

Core CFO responsibilities — Principle 4

- Leading and directing the finance function so that it makes a full contribution to and meets the needs of the business.
- Determining the resources, expertise and systems for the finance function that are sufficient to meet business needs and negotiating these within the overall financial framework.
- Implementing robust processes for recruitment of finance staff and/or outsourcing of functions
- Reviewing the performance of the finance function and ensuring that the services provided are in line with the expectations and needs of its stakeholders.
- Seeking continuous improvement in the finance function.
- Identifying and equipping finance staff, managers and the Leadership Team with the financial competencies and expertise needed to manage the business both currently and in the future.
- Ensuring that the Head of Profession role for all finance staff in the organisation is properly discharged.
- Acting as the final arbiter on application of professional standards.

Personal skills and professional standards	Principle 4

- Create, communicate and implement a vision for the finance function.
- Role model a customer focussed culture within the finance function.
- Establish an open culture, built on effective coaching and a “no blame” approach.
- Promote effective communication within the finance department, across the broader organisation and with external stakeholders.
- Apply strong project planning and process management skills.
- Set and monitor meaningful performance objectives for the finance team.
- Role model effective staff performance management.
- Coach and support staff in both technical and personal development.
- Promote high standards of ethical behaviour, probity, integrity and honesty.
- Ensure, when necessary, that outside expertise is called upon for specialist advice not available within the finance function.
- Promote discussion on current financial and professional issues and their implications.

\ principle 5

The CFO in a public service organisation must be professionally qualified and suitably experienced.

Demonstrating professional and interpersonal skills

The CFO must be able to demonstrate their own professional standing to exercise financial leadership throughout the organisation. As a member of a professional body, the CFO's skills, knowledge and expertise will have been tested by examination and must be continuously developed in a structured and monitored context. The CFO must adhere to the professional values of accuracy, honesty, integrity, objectivity, impartiality, transparency and reliability and promote these throughout the finance function.[5]

The CFO must communicate complex financial information in a clear and credible way. They should be able to operate effectively in different modes including directing, influencing, evaluating and informing. The CFO must also have the confidence to give impartial and objective advice even if it may be unwelcome, and be sufficiently forceful to intervene with authority if financial or ethical principles need to be asserted or defended.

Applying business and professional experience

The CFO must have an understanding and commitment to the wider business, looking beyond narrow financial objectives, to inspire respect, confidence and trust amongst colleagues, inspectors and stakeholders. In practice this means being creative and constructive in strategic roles and effective in management responsibilities, with a sound grasp of approaches such as performance management and project leadership.

The CFO must understand how and when to apply the tools and techniques of financial analysis in support of business decisions in order to evaluate proposals and to offer well founded and expert advice. Such techniques include strategic analysis, review of sector best practice, benchmarking, option appraisal, performance measurement, and risk assessment. However data is not always clear cut and the CFO must also be able to apply judgement to imperfect information.

The CFO must have a good understanding of public sector finance and its regulatory environment and comply with standards formulated through rigorous due process in support of the public interest to support the Leadership Team effectively. The CFO must also have a good understanding of the principles of financial management, and personally set a tone for the organisation that finance matters and is a key part of everyone's job throughout the organisation.

[5] *IFAC: Code of Ethics, 2005*

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Governance requirements — Principle 5

- Appoint a professionally qualified CFO whose core responsibilities include those set out under the other principles in this Statement and ensure that these are properly understood throughout the organisation.
- Ensure that the CFO has the skills, knowledge, experience and resources to perform effectively in both the financial and non-financial areas of their role.

Personal skills and professional standards — Principle 5

- Be a member of an accountancy body recognised by the International Federation of Accountants (IFAC), qualified through examination, and subject to oversight by a professional body that upholds professional standards and exercises disciplinary powers.
- Adhere to international standards set by IFAC on:
  - ethics
  - Continuing Professional Development.
- Demonstrate IT literacy.
- Have relevant prior experience of financial management in the public services or private sector.
- Understand public service finance and its regulatory environment.
- Apply the principles of corporate finance, economics, risk management and accounting.
- Understand personal and professional strengths.
- Undertake appropriate development or obtain relevant experience in order to meet the requirements of the non-financial areas of the role.

\ appendix

Membership of the Public Services Director of Finance Panel

Jon Pittam (Chair)
Hampshire County Council

Graham Duncan / Lindsay Bell
Department for Communities and Local Government

Ally Cook
Formerly of Sport England

Christine Daws
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Steve Freer
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Commission for Local Administration

Jon Thompson
Ministry of Defence

Lee Yale-Helms
PricewaterhouseCoopers

Ian Carruthers (Secretary)
CIPFA

Carole Hicks (Technical support)
CIPFA

CIPFA are grateful to all the members of the Panel for their invaluable contributions, as well as to Sue Beauchamp for her help with the initial drafting. The statement was widely circulated for comment during its drafting and many individuals and organisations responded giving us additional insights into how the CFO operates in practice across the public services.

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APPENDIX 6

The Good Governance Standard for Public Services

The Independent Commission on Good Governance in Public Services

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ISBN: 1 898531 86 2

Design and layout by Amanda Little

Printed by Hackney Press Ltd

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Commission members

Lord Richard Best, Director, Joseph Rowntree Foundation

Sir Ian Blair, Deputy Commissioner, Metropolitan Police Service

Mr Jim Coulter, Chief Executive, National Housing Federation

Ms Lucy de Groot, Executive Director, Improvement and Development Agency

Ms Liz Kerry, Chief Executive, Yorkshire and Humber Assembly

Mr Bob Kerslake, Chief Executive, Sheffield County Council

Mr Ed Mayo, Chief Executive, National Consumer Council

Dr Greg Parston, Executive Chairman, OPM

Ms Bharti Patel, to October 2004 Director of Communications, Ethnic Minority Foundation

The Honourable Barbara Thomas, Deputy Chair, Financial Reporting Council and from September 2004 Chairman, United Kingdom Atomic Energy Authority

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Foreword

By 2005/6, public expenditure in the UK will exceed £500 billion[1]. How this money is spent and the quality of services it provides is critically important to us all as users of services and as taxpayers. Because of this we all need governance of our public services to be of a high standard. Good governance leads to good management, good performance, good stewardship of public money, good public engagement and, ultimately, good outcomes[2].

The governors of our public service organisations face a difficult task. They are the people responsible for governance – the leadership, direction and control of the organisations they serve. Their responsibility is to ensure that they address the purpose and objectives of these organisations and that they work in the public interest. They have to bring about positive outcomes for the people who use the services, as well as providing good value for the taxpayers who fund these services. They have to balance the public interest with their accountability to government and an increasingly complex regulatory environment, and motivate front-line staff by making sure that good executive leadership is in place. Governors shoulder a heavy responsibility in relation to health, education, housing, criminal justice and many other aspects of public service.

More than 450,000 people[3] contribute as governors to a wide range of public service organisations and partnerships. There is clear evidence that many have difficulties in fulfilling these responsibilities[4]. To help them with their tasks, there is an urgent and ongoing need to be clear about the purpose of governance and the role of the governor, expand the supply of governors, improve induction programmes and encourage good relationships between governors and the executive teams who are accountable to them.

It is perhaps surprising that there is no common code for public service governance to provide guidance across the complex and diverse world of public services, which are provided by the public sector and a range of other agencies. The *Good Governance Standard for Public Services* addresses this issue head on. It builds on the Nolan principles[5] for the conduct of individuals in public life, by setting out six core principles of good governance for public service organisations. It shows how these should be applied if organisations are to live up to the Standard and provides a basis for the public to challenge sub-standard governance. I hope that the publication of the Standard will encourage public bodies to review their own effectiveness, and that it will provide commissioners and regulators of public services with a common framework for assessing good governance practice.

It has been a privilege to take part in this work and my personal thanks go to the members of the Commission, the Commission secretaries and the head of research, who simply want to help governors do a difficult job better. I also gratefully acknowledge the support provided by the Joseph Rowntree Foundation and the commitment of CIPFA (Chartered Institute of Public Finance and Accountancy) and OPM® (Office for Public Management).

Sir Alan Langlands
Chair of the Commission
January 2005

About the Commission

The Independent Commission on Good Governance in Public Services was established by the Office for Public Management (OPM®) and the Chartered Institute of Public Finance and Accountancy (CIPFA), in partnership with the Joseph Rowntree Foundation. The role of the Commission was to develop a common code and set of principles for good governance across public services.

The Commission began work early in 2004. The first stage was to consult a wide range of stakeholders, through face-to-face discussions and meetings around the UK and a process of inviting written contributions from all types of public service organisations. This consultation focused on the potential value of a common code or set of principles for governing all public services, and sought views on what the code should include.

Following this consultation, the Commission produced a draft of the *Good Governance Standard for Public Services*. The draft was the subject of a second round of consultation in the autumn of 2004. This included meetings with service users and citizens, to explore the potential value of the Standard from their point of view. The Standard was then amended to reflect the views expressed in the consultation.

Further information about the work of the Commission and the responses to both rounds of consultation are available at www.opm.co.uk/ICGGPS.

1 *Spending Review 2004*, HM Treasury

2 For example, standards of corporate governance have a central place in the Audit Commission's comprehensive performance assessment of the quality of services provided by local authorities

3 Estimated number of members of governing bodies of public services in the UK

4 For example *Rubber Stamped*?, OPM, 2003

5 Committee on Standards in Public Life, 1995

Using the Standard

The purpose of the Standard

We intend the *Good Governance Standard for Public Services* as a guide to help everyone concerned with the governance of public services not only to understand and apply common principles of good governance, but also to assess the strengths and weaknesses of current governance practice and improve it. We hope that the Standard will be useful to governors who are striving to do a difficult job better, and to individuals and groups who have an interest in scrutinising the effectiveness of governance.

The Standard focuses on the ways different functions of governance can support each other. Governance is dynamic: good governance encourages the public trust and participation that enables services to improve; bad governance fosters the low morale and adversarial relationships that lead to poor performance or even, ultimately, to dysfunctional organisations.

Scope of the Standard

The *Good Governance Standard for Public Services* is intended for use by all organisations and partnerships that work for the public, using public money. Most of these are public sector organisations whose services are used directly by members of the public or who are responsible for less visible activities, such as regulation and policy development.

However, the use of public money to provide public services is not limited to the public sector. The public also has an interest in the governance of non-public sector organisations that spend public money, and the Standard is designed to help them too.

Relationship with other codes and guidance

While the Standard has a wide scope, it does not seek to duplicate the codes and guidance that already exist for some specific types of organisation. We hope that those who develop and set these codes will refer to the Standard in updating and reviewing their own codes, and use it to enhance the debate about governance within and between different sectors. Where codes and guidance do not already exist, as in many formal and informal partnerships, we hope that the Standard will provide a shared understanding of what constitutes good governance.

Applying the Standard to different governance structures and sizes of organisation

The principles form a universal Standard of good governance and we encourage all organisations to show that they are putting it into practice in a way that reflects their structure and is proportionate to their size. We recognise that not all parts of the Standard will appear to be directly applicable to all types and size of organisation.

The many types of organisations to which the Standard applies – central government and local service providers, and public sector and independent organisations – have a wide range of governance structures; for example, some governing bodies will be elected and some appointed. Organisations also vary enormously in size and complexity, from, for example, a small school to a large hospital trust.

We call on governing bodies to report publicly on the extent to which they live up to the Standard, and explain why and how they have adapted any of the principles and their applications to suit their type and size of organisation. In doing so, we ask organisations to demonstrate the spirit and ethos of good governance, which the Standard aims to capture and which cannot be achieved by rules and procedures alone.

Putting the Standard into practice

The Standard comprises six core principles of good governance, each with its supporting principles. The 'Application' box next to each supporting principle explains what should be done to put it into practice. At the end of each section, good practice examples illustrate ways of putting the principles into practice.

Appendix A comprises questions that governing bodies should ask themselves to test how far they live up to the Standard, and to develop action plans for making any necessary improvements.

Appendix B comprises questions for members of the public or their representatives to ask if they want to understand or challenge the governance of public service organisations. We also suggest that organisations ask themselves these questions to test their own openness and accountability to the public. The questions could be used as a basis for 'frequently asked questions' (FAQs) on public websites.

Terminology

In order to be applicable to different kinds of organisation, the Standard uses some general terms, with the following definitions:

- **Governing body**: the body with overall responsibility for directing and controlling an organisation. For example, the police authority; the governors of a school; the board of a housing association, an NHS trust or a non-departmental public body; the council in local government
- **Governor**: member of the governing body, whether elected or appointed. For example, member of a police authority, school governor, board member of a housing association or non-departmental public body, executive or non-executive director of an NHS trust, elected member or councillor of a local authority
- **Non-executive**: governors without executive responsibilities (non-executive directors are sometimes referred to as independent directors)
- **Executive**: the senior staff of the organisation. Some types of boards include executive directors as governors.

The term 'executive' has a different meaning in local government in England and Wales, where the executive comprises elected representatives. There are three possible structures for the 'executive': a council leader, elected by the full council, who appoints councillors to a cabinet; a directly elected mayor who appoints councillors to a cabinet; a directly elected mayor and a council manager, who is an officer. In NHS foundation trusts, the 'governing body' is the board of directors while the group known as governors form a separate body.

We hope that the Standard will help all those with an interest in public governance to assess good governance practice.

Sir Alan Langlands

Lord Richard Best

Sir Ian Blair

Mr Jim Coulter

Ms Lucy de Groot

Ms Liz Kerry

Mr Bob Kerslake

Mr Ed Mayo

Dr Greg Parston

Ms Bharti Patel

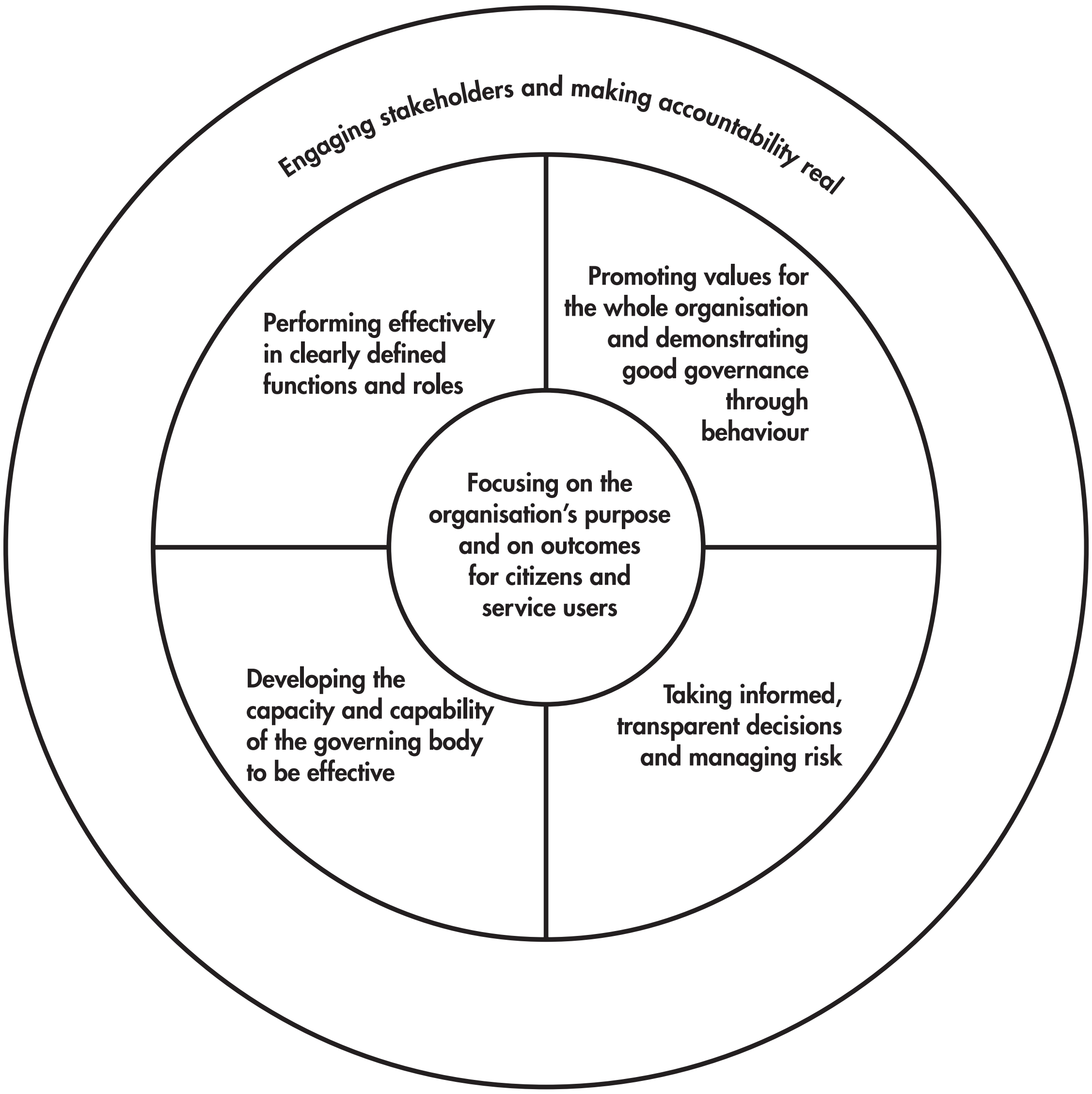
The Honourable Barbara Thomas

Ms Jo Williams CBE

Members of the Independent Commission on Good Governance in Public Services
January 2005

Principles of good governance

The standard comprises six core principles of good governance, each with its supporting principles.



1. Good governance means focusing on the organisation's purpose and on outcomes for citizens and service users

1.1 Being clear about the organisation's purpose and its intended outcomes for citizens and service users

1.2 Making sure that users receive a high quality service

1.3 Making sure that taxpayers receive value for money

2. Good governance means performing effectively in clearly defined functions and roles

2.1 Being clear about the functions of the governing body

2.2 Being clear about the responsibilities of non-executives and the executive, and making sure that those responsibilities are carried out

2.3 Being clear about relationships between governors and the public

3. Good governance means promoting values for the whole organisation and demonstrating the values of good governance through behaviour

3.1 Putting organisational values into practice

3.2 Individual governors behaving in ways that uphold and exemplify effective governance

4. Good governance means taking informed, transparent decisions and managing risk

4.1 Being rigorous and transparent about how decisions are taken

4.2 Having and using good quality information, advice and support

4.3 Making sure that an effective risk management system is in operation

5. Good governance means developing the capacity and capability of the governing body to be effective

5.1 Making sure that appointed and elected governors have the skills, knowledge and experience they need to perform well

5.2 Developing the capability of people with governance responsibilities and evaluating their performance, as individuals and as a group

5.3 Striking a balance, in the membership of the governing body, between continuity and renewal

6. Good governance means engaging stakeholders and making accountability real

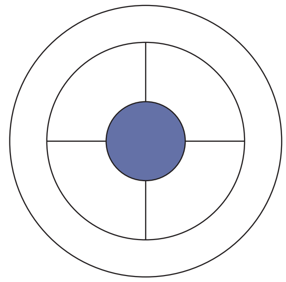
6.1 Understanding formal and informal accountability relationships

6.2 Taking an active and planned approach to dialogue with and accountability to the public

6.3 Taking an active and planned approach to responsibility to staff

6.4 Engaging effectively with institutional stakeholders

1. Good governance means focusing on the organisation's purpose and on outcomes for citizens and service users



The function of governance is to ensure that an organisation or partnership[6] fulfils its overall purpose, achieves its intended outcomes for citizens and service users, and operates in an effective, efficient and ethical manner[7]. This principle should guide all governance activity.

Each organisation has its own purpose. There are also some general purposes that are fundamental to all public governance, including providing good quality services and achieving value for money.

The concept of 'public value' can be helpful when thinking about the unique purpose of public services and therefore of their governance. Public value refers to the things that public services produce, either directly or indirectly, using public money. Public value includes: outcomes (such as improved health and improved safety); services (such as primary care services and policing); and trust in public governance.

1.1 Being clear about the organisation's purpose and its intended outcomes for citizens and service users

Having a clear organisational purpose and set of objectives is a hallmark of good governance. If this purpose is communicated effectively, it can guide people's actions and decisions at all levels in an organisation.

For many organisations, others (in particular, central government[8]) play a major role in determining policy and resources and in setting or agreeing objectives. In these circumstances, it is critically important that there is a common view of the organisation's purposes and its intended outcomes.

Application

The governing body should make sure that there is a clear statement of the organisation's purpose and that it uses this as a basis for its planning. It should constantly review the decisions it takes, making sure that they further the organisation's purpose and contribute to the intended outcomes for citizens and users of services.

6 Throughout the document, 'organisation' should be read to include 'partnership'.

7 For example, a school's purpose might be to educate children; its intended outcomes might include improved literacy and numeracy of children by the age of 11.

8 Often described as a 'dominant stakeholder' role.

1.2 Making sure that users receive a high quality service

All public service organisations provide a service to other people and/or organisations, although not all provide services directly to members of the public. The quality of service is an important measure of how effective an organisation is, and so it is particularly important in governance.

Users of public services, unlike consumers in the private sector, usually have little or no option to go elsewhere for services or to withdraw payment[9]. Providers of public services have fewer direct financial incentives than private companies to improve consumer satisfaction. Organisations that provide public services therefore need to take additional steps to ensure that services are of a high quality.

Application

The governing body should decide how the quality of service for users is to be measured and make sure that it has the information it needs to review service quality effectively and regularly.

As part of this, it should ensure that it has processes in place to hear the views of users and non-users from all backgrounds and communities about their needs, and the views of service users from all backgrounds about the suitability and quality of services. The governing body should use this information when making decisions about service planning and improvement.

1.3 Making sure that taxpayers receive value for money

All organisations that spend public money, either in commissioning services or providing them directly, have a duty to strive for economy, efficiency and effectiveness in their work. Citizens and taxpayers have an important and legitimate interest in the value for money provided by organisations that use public money.

Application

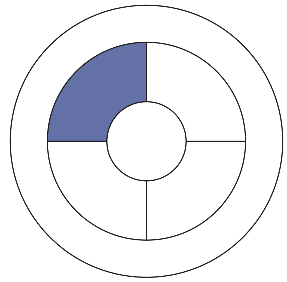
The governing body should decide how value for money is measured and make sure that it has the information it needs to review value for money effectively, including information about similar organisations, for comparison. It should use this information when planning and reviewing the work of the organisation.

Good practice examples: focusing on the organisation's purpose and on outcomes for citizens and service users

- Compare information about the efficiency, effectiveness and quality of service provided by similar organisations; analyse why levels of efficiency, effectiveness and quality are different elsewhere.
- Give non-executive directors a specific responsibility to ensure that information about users' experiences is collected, brought to the attention of the governing body and used in its decision making.

9 Government policy is to increase choice in public services; nevertheless, consumer choice is either not available or limited in most areas of public services.

2. Good governance means performing effectively in clearly defined functions and roles



Good governance requires all concerned to be clear about the functions of governance and their own roles and responsibilities and those of others, and to behave in ways that are consistent with those roles. Being clear about one's own role, and how it relates to that of others, increases the chance of performing the role well. Clarity about roles also helps all stakeholders to understand how the governance system works and who is accountable for what.

2.1 Being clear about the functions of the governing body

Members of governing bodies are elected or appointed to ***direct and control public service organisations in the public interest***[10].

The primary functions of the governing body are to:

- establish the organisation's strategic direction and aims, in conjunction with the executive
- ensure accountability to the public for the organisation's performance
- assure that the organisation is managed with probity and integrity.

In order to direct strategy and ensure that this is implemented and that the organisation achieves its goals, the governing body has to:

- allocate resources and monitor organisational and executive performance[11]
- delegate to management
- oversee the appointment and contractual arrangements for senior executives, and make sure that effective management arrangements are in place
- understand and manage risk.

Ways of achieving these primary functions include:

- constructively challenging and scrutinising the executive
- ensuring that the voice of the public is heard in decision making
- forging strategic partnerships with other organisations.

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10 Governors of charities (trustees) have an overriding duty to act in the interests of their charity and its beneficiaries, who are defined as part of its registration as a charity. Industrial and provident societies (mutuals) may be either for the mutual benefit of their members or of the community, depending on their form of registration.

11 Throughout, the term 'executive' is used to refer to the senior members of the organisation's paid staff.

Some of these functions are the particular responsibility of non-executive directors, where the governing body comprises both non-executive and executive members (see 2.2).

Application

The governing body should set out clearly, in a public document, its approach to performing each of the functions of governance. This should include a process, agreed with the executive, for holding the executive to account for achieving agreed objectives and implementing strategy. The governors should explain how and why their approach to each function is appropriate for the size and complexity of the organisation.

2.2 Being clear about the responsibilities of non-executives and the executive, and making sure that those responsibilities are carried out

Different public services have different types of governing body. In some cases, executive directors are members of the governing body; in other cases the governing body is made up entirely of non-executives. For example, NHS trusts have 'unified boards' that usually comprise five executive directors, five non-executive directors and the non-executive chair. In contrast, police authorities and some national public bodies have a 'supervisory body' made up entirely of non-executives. Government departments and non-departmental public bodies have accounting officers (usually the permanent secretary of a government department and the chief executive of an NDPB) who have personal responsibility to Parliament for the use of public funds.

In all cases, the governors take collective responsibility for the governing body's decisions. In both unified and supervisory arrangements, non-executives have specific responsibilities in relation to the executive.

Non-executive

The non-executive role is to:

- contribute to strategy: non-executives bring a range of perspectives to strategy development and decision making
- make sure that effective management arrangements and an effective team are in place at the top level of the organisation
- delegate: non-executives help to clarify which decisions are reserved for the governing body, and then clearly delegate the rest
- hold the executive to account: the governing body delegates responsibilities to the executive. Non-executives have a vital role in holding the executive to account for its performance in fulfilling those responsibilities, including through purposeful challenge and scrutiny
- be extremely discriminating about getting involved in matters of operational detail for which responsibility is delegated to the executive.

Chair and chief executive (or lead executive)

The chair and chief executive share in the leadership role. The chair's role is to lead the governing body, ensuring it makes an effective contribution to the governance of the organisation; and the chief executive's is to lead the organisation in implementing strategy and managing the delivery of services. A good working relationship between the two can make a significant contribution to effective governance.

The deputy chair's role includes supporting the chair in his or her role, and, on occasion, informing the chair of any concerns that governors have about the conduct of the governing body.

Application

The governing body should clarify that all its members have collective responsibility for its decisions and have equal status in discussions. The chair and other governors should challenge individual governors if they do not respect constructive challenge by others or if they do not support this collective responsibility for fulfilling the organisation's purpose and for working towards intended outcomes for citizens and users of services.

The governing body should set out a clear statement of the respective roles and responsibilities of the non-executives and the executive and its approach to putting this into practice.

The roles of chair and chief executive should be separate and provide a check and balance for each other's authority. The chair and the chief executive should negotiate their respective roles early in the relationship (within a framework in which the chair leads the governing body and the chief executive leads and manages the organisation) and should explain these clearly to the governing body and the organisation as a whole.

2.3 Being clear about relationships between governors and the public

Governors and governing bodies need to be clear about the nature of their relationship with the public. The governing body's role is to direct and control the organisation in the public interest (see 2.1) and to ensure accountability to the public (see 6.2). Being clear about this increases the chances that governors and others will understand governors' responsibilities to the public and be aware of the limitations of what they can be expected to do.

Public service governors are either elected directly by the public or appointed by governing bodies and/or government[12] . All governors share collective responsibility and accountability for the governing body's decisions[13]. This includes the governing body of a partnership, whose members may come from a range of organisations. As governors of the partnership, they are responsible for taking decisions that support the partnership's purpose, not simply the interests of their 'parent' organisation.

Their different routes to becoming a governor mean that elected and appointed governors have different types of relationship with the public. However, both are

12 Some charity trustees or governors of other independent not-for-profit organisations, such as housing associations, are appointed by a wider voting membership or by other external bodies.

13 Organisations in which political parties are prominent, e.g. local authorities, may by convention operate a system of collective responsibility within the controlling party or alliance, rather than within the governing body as a whole.

accountable to the public and should develop a dialogue that connects the organisation properly with the public they serve (see 6.2). The electoral process provides an additional accountability mechanism for elected governors and they can be said to represent the public, in the democratic sense of 'represent'.

Appointed governors' backgrounds and experience are often factors in their appointment. This means that they bring particular perspectives or expertise, but their views cannot be expected to be 'representative' or typical of others with similar backgrounds.

It is very important that a wide range of experiences and perspectives inform governance decisions. This is enhanced by the participation of a cross-section of the public in governance decision making (see 5.1).

Application

Governors should recognise their collective responsibility for the governing body's decisions and strive to make decisions that further the organisation's purpose, rather than the interests of any specific group or organisation with which they are associated.

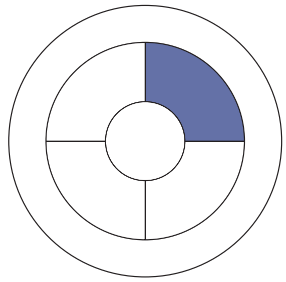
The governing body should value the perspectives which governors appointed from different backgrounds bring, but should make clear that these appointed governors are not expected to provide the only source of information about the specific groups whose background or experiences they share. Where appointed governors are asked to provide authoritative information about the views and experiences of such groups, they should have access to systems for collecting this information.

The governing body, whether elected or appointed (or made up of both elected and appointed governors) should ensure that the organisation engages effectively with the public and service users to understand their views, and that the governing body has access to reliable information about the range of public opinions and the satisfaction of all groups of users of services.

Good practice examples: performing effectively in clearly defined functions and roles

- The governing body can meet its responsibility for strategy by scrutinising and challenging proposals developed by the executive, or by involving itself actively in strategy formulation from the earliest stages.
- In developing and pursuing the organisation's strategic direction, the governing body is advised to make judgements about, and help to regulate, the scale and pace of change that the organisation can handle successfully.
- In appointing and remunerating the top team, it is good practice to establish a remuneration and appointments committee, made up of governors who are free of vested interests, to make recommendations to the governing body.
- Publishing job descriptions for the chair, deputy chair and chief executive can help others to know what to expect.
- Even for small organisations or partnerships with limited resources, separation of the chair and the executive role is advisable, with the executive being responsible for putting decisions into practice.

3. Good governance means promoting values for the whole organisation and demonstrating the values of good governance through behaviour



Good governance flows from a shared ethos or culture, as well as from systems and structures. It cannot be reduced to a set of rules, or achieved fully by compliance with a set of requirements. This spirit or ethos of good governance can be expressed as values and demonstrated in behaviour.

Good governance builds on the seven principles for the conduct of people in public life that were established by the Committee on Standards in Public Life. Known as the Nolan principles, these are: selflessness, integrity, objectivity, accountability, openness, honesty and leadership.

3.1 Putting organisational values into practice

A hallmark of good governance is the development of shared values, which become part of the organisation's culture, underpinning policy and behaviour throughout the organisation, from the governing body to all staff. These are in addition to compliance with legal requirements on, for example, equal opportunities and anti-discrimination.

Application

The governing body should take the lead in establishing and promoting values for the organisation and its staff. These values should be over and above legal requirements (for example, anti-discrimination, equal opportunities and freedom of information legislation) and should build on the Nolan principles. They should reflect public expectations about the conduct and behaviour of individuals and groups who control public services[14]. The governing body should keep these values at the forefront of its own thinking and use them to guide its decision making.

14 For example, *National Centre for Social Research and Centre for Research into Elections and Social Trends Guiding Principles: Public Attitudes Towards Conduct in Public Life,* The Committee on Standards in Public Life, January 2003

3.2 Individual governors behaving in ways that uphold and exemplify effective governance

Individual behaviour is a major factor in the effectiveness of the governing body, and also has an influence on the reputation of the organisation, the confidence and trust members of the public have in it and the working relationships and morale within it. Conflicts, real or perceived, can arise between the organisation's interests and those of individual governors (see 4.1). Public trust can then be damaged unless the organisation implements clear procedures to deal with these conflicts.

Application

Governors should live up to the Nolan principles and to any approved codes or guides to ethical conduct for their organisation or sector. They should also demonstrate through their behaviour that they are focusing on their responsibilities to the organisation and its stakeholders.

Good practice examples: promoting values for the whole organisation and demonstrating the values of good governance through behaviour

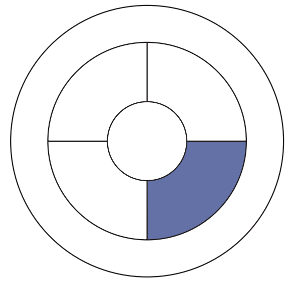
The governing body promotes and upholds values for the organisation. These may include:

- responding to a diverse public and striving to reduce inequality among service users
- committing to openness and transparency in decisions and use of resources
- striving for public good and ignoring personal interests
- promoting good relationships within the organisation, with the public and service users and with other organisations.

The governing body makes clear the standards of behaviour that it expects from governors and staff. Good practice in the behaviour of individual governors may include:

- attending regularly and being actively involved in decision making
- informing oneself and preparing for decision making
- making contact with other organisations and forging and maintaining links with the world outside the organisation
- engaging willingly and actively with the public, service users and staff, within an agreed communication framework.

4. Good governance means taking informed, transparent decisions and managing risk



Decision making in governance is complex and challenging. It must further the organisation's purpose and strategic direction and be robust in the medium and longer terms. To make such decisions, governors must be well informed.

Governors making decisions need the support of appropriate systems, to help to ensure that decisions are implemented and that resources are used legally and efficiently. A governing body may, for example, adopt the discipline of formally reviewing implementation of a new policy after a defined initial period, to see whether it is working as intended.

Risk management is important to the successful delivery of public services. An effective risk management system identifies and assesses risks, decides on appropriate responses and then provides assurance that the chosen responses are effective.

4.1 Being rigorous and transparent about how decisions are taken

Different types of organisation have different statutory requirements for the publication of their decisions[15]. Over and above these requirements, transparent decisions that are clearly explained are more likely to be understood by staff, the public and other stakeholders and to be implemented effectively. It is also easier to evaluate the impact of decisions that are transparent, and therefore to have evidence on which to draw in making future decisions.

A hallmark of good governance is a clearly defined level of delegation by the governing body to the executive for decision making. The governing body sets policies as parameters within which the executive works on the behalf of the governing body. For this to work well, it is important that governors do not concern themselves with levels of detail that are inappropriate for their role, while ensuring that they are not too far removed to provide effective oversight and scrutiny.

Application

The governing body should draw up a formal statement that specifies the types of decisions that are delegated to the executive and those that are reserved for the governing body.

Governing bodies should state clear objectives for their decisions. In their public record of decisions and in explaining them to stakeholders, they should be explicit about the criteria, rationale and considerations on which decisions are based, and, in due course, about the impact and consequences of decisions.

15 There are also statutory requirements for the types of decisions and information that can or must be excluded from the public domain, e.g. information about individuals.

Conflicts can arise between the personal interests of individuals involved in making decisions and decisions that the governing body needs to make in the public interest. To ensure probity and to avoid public concern or loss of confidence, governing bodies have to take steps to avoid any such conflicts of interest, whether real or perceived.

4.2 Having and using good quality information, advice and support

Good quality information and clear, objective advice can significantly reduce the risk of taking decisions that fail to achieve their objectives or have serious unintended consequences. Governors need to receive rigorous analyses of comprehensive background information and evidence, and of the options for action. As governance decisions are complex and can have significant consequences, governors also need professional advice. This includes advice on, for example, legal and financial matters and governance procedures. Such professional advice is also needed at other levels in the organisation where decisions are taken.

Application

The governing body should ensure that it is provided with information that is fit for purpose. It should be tailored to the functions of the governing body (see 2.2) and not to detailed operational or management issues, with which the governing body should not, in general, be concerned. Information should provide a robust analysis and not obscure the key information by including too much detail.

The governing body should ensure that information is directly relevant to the decisions it has to take; is timely; is objective; and gives clear explanations of technical issues and their implications. The governing body should also ensure that professional advice on legal and financial matters is available and used appropriately in its own decision making and elsewhere throughout the organisation when decisions that have significant legal or financial implications are taken.

The governing body should not be reluctant to use the organisation's resources to provide the information and advice that is needed for good governance. However, it should not make disproportionate demands on the executive by asking for information that is not necessary or appropriate for the governing body's role. The governing body should arrive at a judgement about its information needs in discussion with the executive.

4.3 Making sure that an effective risk management system is in operation

Public service organisations face a wide range of strategic, operational and financial risks, from both internal and external factors, which may prevent them from achieving their objectives. Risk management is a planned and systematic approach to identifying, evaluating and responding to risks and providing assurance that responses are effective.

A risk management system should consider the full range of the organisation's activities and responsibilities, and continuously check that various good management disciplines are in place, including:

- strategies and policies are put into practice in all relevant parts of the organisation
- strategies and policies are well designed and regularly reviewed
- high quality services are delivered efficiently and effectively
- performance is regularly and rigorously monitored and effective measures are put in place to tackle poor performance
- laws and regulations are complied with
- information used by the organisation is relevant, accurate, up-to-date, timely and reliable
- financial statements and other information published by the organisation are accurate and reliable
- financial resources are managed efficiently and effectively and are safeguarded
- human and other resources are appropriately managed and safeguarded.

A risk management system also supports the annual statement on internal control that many public service organisations now have to produce. Appropriate responses to risk will include implementing internal controls, insuring against the risk, terminating the activity that is causing the risk, modifying the risk or, in some circumstances, accepting the risk.

Application

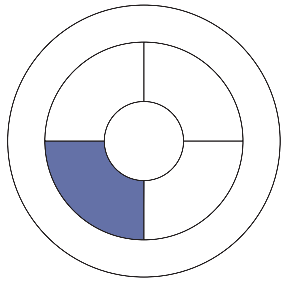
The governing body should ensure that the organisation operates an effective system of risk management. This should include:

- identifying key strategic, operational and financial risks
- assessing the possible effects that the identified risks could have on the organisation
- agreeing on and implementing appropriate responses to the identified risks (internal control, insure, terminate, modify, accept)
- putting in place a framework of assurance from different sources, to show that risk management processes, including responses, are working effectively
- reporting publicly on the effectiveness of the risk management system through, for example, an annual statement on internal control, including, where necessary, an action plan to tackle any significant issues
- making it clear that the governing body carries ultimate responsibility for the risk management system.

Good practice examples: taking informed, transparent decisions and managing risk

- It is helpful to draw on the support of an officer or independent adviser who can advise on legal issues and procedure, and who has the authority and status to challenge governance practice if necessary. This works best where there are safeguards and reporting relationships in place to make sure that advice is not easily ignored.
- A register of governors' and executives' interests will make governing bodies and others aware of any real or perceived conflicts of interest and facilitate the exclusion of people with personal interests in a decision from influencing or taking part in that decision.
- Documenting all risks in a risk register, together with the risk 'score' and the job title of the person responsible for ensuring that the risk is managed, will help with risk management.
- The highest risks in the register can be given priority in review procedures to provide assurance on the effectiveness of risk responses.
- Gaining assurance that risk management arrangements are working effectively can be delegated to an audit committee or equivalent body, where the size of the organisation makes this practical.
- Relevant work of internal audit, external audit, review agencies and inspectorates can be drawn on to provide assurance on the effectiveness of risk management.
- From time to time, governing bodies may decide to commission information from independent sources, outside the executive, in order to supplement or validate information from the executive.

5. Good governance means developing the capacity and capability of the governing body to be effective



Public service organisations need people with the right skills to direct and control them effectively. Governing bodies should consider the skills that they need for their particular situation. To increase their chances of finding these people – and to enrich governance deliberations by bringing together a group of people with different backgrounds – governing bodies need to recruit governors from different parts of society. Public trust and confidence in governance will increase if governance is not only done well, but is done by a diverse group of people who reflect the community.

Governance is also likely to be more effective and dynamic if new people with new ideas are appointed regularly, but this needs to be balanced with the need for stability to provide continuity of knowledge and relationships.

5.1 Making sure that appointed and elected governors have the skills, knowledge and experience they need to perform well

Governance roles and responsibilities are challenging and demanding, and governors need the right skills for their roles. In addition, governance is strengthened by the participation of people with many different types of knowledge and experience[16].

Good governance means drawing on the largest possible pool of potential governors to recruit people with the necessary skills. Encouraging a wide range of people to apply for appointed positions or to stand for election will develop a membership that has a greater range of experience and knowledge. It will also help to increase the diversity of governors in terms of age, ethnic background, social class and life experiences, gender and disability[17].

Paying governors for their time may make participation in governance a practical option for more people and encourage a wider range of people to take part; it can also be a way of publicly recognising the seriousness of governance responsibilities[18].

16 For example www.london.edu/tysonreport/Tyson_Report_June_2003.pdf – *Tyson Report on the Recruitment and Development of Non-Executive Directors*, London Business School, June 2003 (A report commissioned by the Department of Trade and Industry following the publication of the Higgs Review of the Role and Effectiveness of Non-Executive Directors in January 2003).

17 See, for example, *A Simple Step Guide to Recruitment*, Office of the Commissioner for Public Appointments.

18 Approaches to paying governors are generally determined by statute and vary between types of organisation. For example, charities are generally prohibited from paying their governors (trustees).

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Application

The governing body should assess the skills that appointed governors need to fulfil their functions. It should appoint governors who have these skills, using an open and skills-based recruitment process.

A governing body with elected members should commit itself to developing the skills that it has decided its members need, so that they can carry out their roles more effectively.

Where governing bodies are responsible for their own recruitment processes, they should establish an appointments committee and ensure that their recruitment processes can identify and attract the types of people they want. Where an outside body makes appointments, it should consult the governing body about the skills and experience it considers to be necessary or desirable in the new appointee. In these cases, the process should include an independent assessor – a person from outside the organisation who can advise on the suitability of candidates.

Where other organisations nominate people to become governors, the governing body should set out clearly to the nominating body the set of skills and perspectives that would be most helpful.

The governing body should decide how to encourage more people, from a wider cross-section of society, to come forward as potential governors. This includes reviewing the governor's role to make sure that: it is fulfilling and coherent; it is feasible to do within the time and with the support available; and it is sufficiently well understood by potential governors. The search for a more diverse membership of the governing body should not be at the expense of a membership that has the necessary skills.

5.2 Developing the capability of people with governance responsibilities and evaluating their performance, as individuals and as a group

Governors need both skills and knowledge to do their jobs well. Skills need to be developed continually to improve performance in the functions of the governing body (see 2.1). The necessary skills include the ability to scrutinise and challenge information received from the executive, including skills in financial management and the ability to recognise when outside expert advice is needed. Knowledge also needs to be updated regularly to equip governors for changing circumstances.

An appraisal and performance review of individual governors demonstrates that their role and contribution is important and valued and provides an opportunity for them to take stock of their own development needs. The governing body can improve its collective performance by taking the time to step back and consider its own effectiveness.

Application

New governors should receive a thorough induction that is tailored to their role in the organisation. All governors should have opportunities to develop further skills and to update their knowledge throughout their period of membership of the governing body, and should take seriously their responsibilities to identify and address their development needs.

Individual governors should be held to account for their contribution through regular performance reviews. These should include an assessment of any training or development needs.

The governing body should regularly review its performance as a whole. The review should involve assessing its ways of working and achievements and agreeing an action plan to put in place any necessary improvements.

5.3 Striking a balance, in the membership of the governing body, between continuity and renewal

All governing bodies need continuity in their membership, so that they can make the most of the pool of knowledge and understanding and the relationships that have been formed both inside and outside the organisation. It is also important that governing bodies are stimulated by fresh thinking and challenge and that they avoid lapsing into familiar patterns of thinking and behaviour that may not best serve the organisation's purpose. However, turnover in membership that is too extensive or too frequent can mean that the organisation loses the benefit of longer-serving members' learning and experience.

Application

The governing body should decide how to strike the necessary balance, in its appointed membership, between continuity in knowledge and relationships on the one hand, and renewal of thinking on the other. It should explain the reasons for its policy.

Where an outside body appoints governors, the governing body should explain its preferred approach to continuity and renewal.

Options include fixed terms of membership or limits on the number of terms a governor can serve. Another option is to assess individual governors for their continuing objectivity every time they are being considered for reappointment; independence of mind and the ability to take new approaches are enduring characteristics of some individuals.

Good practice examples: developing the capacity and capability of the governing body to be effective

- Bodies that nominate governors for other organisations are advised to present more than one nominee for interview.
- People appointing governors to public service organisations could consider what they might do to develop further the pool of people interested in public service governance, and to develop the capability of potential governors who do not yet have the skills needed for the role.
- It is good practice to review continually the range of expertise needed on the governing body, so that any gaps can be filled when posts become vacant and when training and development plans are made.
- A skills audit of the members of a governing body is a useful way of identifying their strengths and any skills gaps.
- The governing body can avoid over-dependence on a few individuals by making sure that enough governors have the critical skills.
- Induction for governors could include an introduction to the local environment and the sector, the organisation's relationships with other bodies and the context for the organisation's strategy.
- It can be useful to review a governor's needs for further information or explanation six months or a year after his or her induction.
- Paying governors for their time (as well as meeting expenses) is controversial in some sectors. Considering the advantages and disadvantages can help organisations decide whether payment will strengthen the membership and performance of the governing body or undermine its values.
- By sharing specific responsibilities among its members on a rota basis, the governing body can ensure that important knowledge is not vested in one or a few individuals.

6. Good governance means engaging stakeholders and making accountability real

Governing bodies of public services have multiple accountabilities: to the public (citizens) and to those who have the authority, and responsibility, to hold them to account on the public's behalf. These include: commissioners of services, Parliament, ministers, government departments and regulators[19].

Real accountability requires a relationship and a dialogue. The Public Services Productivity Panel[20] said that accountability involves an agreed process for both giving an account of your actions and being held to account; a systematic approach to put that process into operation; and a focus on explicit results or outcomes. Real accountability is concerned not only with reporting on or discussing actions already completed, but also with engaging with stakeholders to understand and respond to their views as the organisation plans and carries out its activities.

6.1 Understanding formal and informal accountability relationships

The range and strength of different accountability relationships varies for different types of governing bodies. For any governing body, some relationships will be, or will feel, more formal and possibly more important than others. For example, the board of a non-departmental public body is likely to have a closer and more direct relationship with a minister than a school would have. However, the large majority of governing bodies need to be particularly active in developing and maintaining a dialogue with the public.

Governing bodies that are elected by the public (such as local councils) have accountability relationships with central government that are less direct and less powerful than, for example, the relationships that non-departmental public bodies have with central government. But even elected bodies are held to account by central government and regulators for some responsibilities. This is why it is important for central government and regulators to facilitate good governance in the organisations they direct or hold to account.

Application

The governing body should make clear, to itself and to staff, to whom it is accountable and for what. It should assess the extent to which each relationship serves its purpose, including whether any relationships need to be strengthened and whether any dominate to the detriment of serving the purpose of the organisation and being accountable to other stakeholders. If so, the governing body should discuss those tensions and work to fill any gaps in its accountability. It should also raise any concerns with those organisations to which it is formally accountable and, where possible, try to negotiate a more balanced position.

19 Outside the public sector, accountability is not to citizens but to their own stakeholders and to regulators acting in the public interest.

20 *Accountability for Results*, Public Services Productivity Panel, HM Treasury, 2002

6.2 Taking an active and planned approach to dialogue with and accountability to the public

For elected governors, the manifesto and the ballot box are the foundation of the accountability relationship; but good governance also requires an ongoing dialogue between them and their electorate. Appointed governing bodies also have to develop an accountability relationship through dialogue.

The fuel of this dialogue is interest and confidence. If dialogue is to develop and continue, organisations need to encourage and maintain the interest and confidence of the public and service users. Although these two groups overlap to a large extent in their relationship with public service organisations, the relationship with the public is one of accountability, whereas the relationship with service users is one of consultation and responsiveness. Both groups are diverse, consisting of people with different characteristics and experiences and from many different backgrounds. Approaches to developing a dialogue have to recognise these differences, so that the views of a full range of people are heard.

Confidence and interest can both be damaged easily, especially when things go wrong. The organisation's ability to respond to such circumstances is also an important demonstration of its accountability.

Application

The governing body should make it clear that the organisation as a whole seeks and welcomes feedback, and ensure that it responds quickly and responsibly to comment. Complaints are a vital and necessary part of feedback, and there should be clear leadership within the governing body on handling and resolving them, and ensuring the lessons learnt are used to improve the service.

The governing body should ensure that the organisation has a clear policy on the types of issues on which it will consult or engage the public and service users, respectively. This policy should clearly explain how the organisation will use this input in decision making and how it will feed these decisions back to the public and to service users. The policy should make sure that the organisation hears the views and experiences of people of all backgrounds.

Each year, the governing body should publish the organisation's purpose, strategy, plans and financial statements, as well as information about the organisation's outcomes, achievements and the satisfaction of service users in the previous period.

6.3 Taking an active and planned approach to responsibility to staff

Staff are accountable to the governing body, but the governing body also has serious responsibilities, as an employer, to the staff. Recruiting, motivating and keeping staff are vital issues if public services are to be effective. The governing body needs to provide an environment in which staff can perform well and deliver effective services, by creating a culture that welcomes ideas and suggestions, responds to staff views and explains decisions. The governing body is itself the last point of appeal for staff with complaints or concerns that they have not been able to deal with through the organisation's management structures.

Application

The governing body should have a clear policy on when and how it consults and involves staff and their representatives in decision making.

The governing body should make sure that effective systems are in place to protect the rights of staff. It should make sure that policies for whistle blowing, and support for whistle blowers, are in place.

6.4 Engaging effectively with institutional stakeholders

Institutional stakeholders are other organisations with which the organisation needs to work for formal accountability or to improve services and outcomes. Public services have a complex network of governance relationships involving lateral relationships between partners and hierarchical relationships between Parliament, central government and local organisations. Some of these are accountability relationships, while others are to do with working together to achieve better outcomes.

Few public service organisations can achieve their intended outcomes through their own efforts alone. Relationships with other organisations are important, especially if they provide similar or related services or serve the same users or communities. Developing formal and informal partnerships may mean that organisations can use their resources more effectively or offer their services in a different and, for service users, more beneficial way.

Application

The governing body should take the lead in forming and maintaining relationships with the leaders of other organisations, as a foundation for effective working relationships at operational levels.

Good practice examples: engaging stakeholders and making accountability real

- It is good practice to assess the effectiveness of policy and arrangements for dialogue with service users and accountability to the public, to evaluate their impact on decisions and to decide what improvements may be needed.
- Organisations can use a range of models, from citizens' juries to community time banks (mutual volunteering by members of the public, working alongside service providers to support their neighbours), to promote public and user involvement in public service design, delivery and evaluation.
- It is good practice to publish information on research into the public's views of the organisation and information on service users' views of the suitability and quality of the services they receive. It is important to include the diversity of the public and of service users in this information, to give a complete and accurate picture.
- The Independent Commission on Good Governance recommends that governing bodies assess the extent to which they are applying these principles of good governance, and report publicly on this assessment, including an action plan for improvement where necessary.
- By organising systematic '360-degree' feedback from a representative sample of stakeholders, governing bodies can gain valuable insights about the organisation's relationships.

Appendix A: Assessment questions for governors and governing bodies to ask themselves

1. Good governance means focusing on the organisation's purpose and on outcomes for citizens and users

- How clear are we about what we are trying to achieve as an organisation? Do we always have this at the front of our minds when we are planning or taking decisions? How well are we doing in achieving our intended outcomes?
- To what extent does the information that we have about the quality of service for users help us to make rigorous decisions about improving quality? Do we receive regular and comprehensive information on users' views of quality? How could this information be improved? How effectively do we use this information when we are planning and taking decisions?
- To what extent does the information that we have on costs and performance help us to make rigorous decisions about improving value for money? How effectively do we use this information when we are planning and taking decisions? How well do we understand how the value we provide compares with that of similar organisations?

2. Good governance means performing effectively in clearly defined functions and roles

- Do we all know what we are supposed to be doing?
- Is our approach to each of the governing body's main functions clearly set out and understood by all in the governing body and the senior executive? What does the size and complexity of our organisation mean for the ways in which we approach each of the main functions of governance?
- How clearly have we defined the respective roles and responsibilities of the non-executives and the executive, and of the chair and the chief executive? Do all members of the governing body take collective responsibility for the governing body's decisions?
- How well does the organisation understand the views of the public and service users? Do we receive comprehensive and reliable information about these views and do we use it in decision making?

3. Good governance means promoting values for the whole organisation and demonstrating the values of good governance through behaviour

- What are the values that we expect the staff to demonstrate in their behaviour and actions? How well are these values reflected in our approach to decision making? What more should we do to ensure these values guide our actions and those of staff?
- In what ways does our behaviour, collectively as a governing body and individually as governors, show that we take our responsibilities to the organisation and its stakeholders very seriously? Are there any ways in which our behaviour might weaken the organisation's aims and values?

4. Good governance means taking informed, transparent decisions and managing risk

- How well do our meetings work? What could we do to make them more productive and do our business more effectively?
- Have we formally agreed on the types of decisions that are delegated to the executive and those that are reserved for the governing body? Is this set out in a clear and up-to-date statement? How effective is this as a guide to action for the governing body and the executive? How well do we explain the reasons for our decisions to all those who might be affected by them?
- Is the information we receive robust and objective? How could the information we receive be improved to help improve our decision making? Do we take professional advice to inform and support our decision making when it is sensible and appropriate to do so?
- How effective is the organisation's risk management system? How do we review whether this system is working effectively? Do we develop an action plan to correct any deficiencies in the systems? If so, do we publish this each year?

5. Good governance means developing the capacity and capability of the governing body to be effective

- What skills have we decided that governors must have to do their jobs effectively? How well does our recruitment process identify people with the necessary skills and reach people from a wide cross-section of society? What more could we do to make sure that becoming a governor is practical for as many people as possible?
- How effective are we at developing our skills and updating our knowledge? How effective are our arrangements for reviewing the performance of individual governors? Do we put into practice action plans for improving our performance as a governing body?

- What is our approach to finding a balance between continuity of knowledge and renewal of thinking in the governing body? What are our reasons for this approach? Do we need to review it?

6. Good governance means engaging stakeholders and making accountability real

- Who are we accountable to and for what? How well does each of these accountability relationships work? Do we need to take steps to clarify or strengthen any relationships? Do we need to negotiate a shift in the balance between different accountability relationships?
- What is our policy on how the organisation should consult the public and service users? Does it explain clearly the sorts of issues on which it will consult which groups and how it will use the information it receives? Do we need to review this policy and its implementation?
- What is our policy on consulting and involving staff and their representatives in decision making? Is this communicated clearly to staff? How well do we follow this in practice? How effective are systems within the organisation for protecting the rights of staff?
- Who are the institutional stakeholders that we need to have good relationships with? How do we organise ourselves to take the lead in developing relationships with other organisations at the most senior level?

Applying the good governance Standard

- To what extent does the *Good Governance Standard for Public Services* apply to our organisation, bearing in mind its type and size?
- Are we upholding and demonstrating the spirit and ethos of good governance that the Standard sets out to capture?
- Do we have a process for regularly reviewing our governance arrangements and practice against the Standard? What further improvements do we need to make?
- Are we making public the results of our reviews and our plans for future improvements and are we inviting feedback from stakeholders and service users?

Appendix B: Questions for members of the public and their representatives to ask if they want to assess and challenge standards of governance

Organisations can also ask themselves these questions if they want to test their openness and responsiveness to the public and their service users.

1. Good governance means focusing on the organisation's purpose and on outcomes for citizens and service users

- What is this organisation for?
- Can I easily find a clear explanation of what this organisation is doing?
- Can I easily find out about the quality of service provided to the public?
- What is being done to improve services?
- Can I easily find out about the organisation's funding and how it spends its money?

2. Good governance means performing effectively in clearly defined functions and roles

- Who is in charge of the organisation?
- How are they elected or appointed?
- At the top of the organisation, who is responsible for what?

3. Good governance means promoting values for the whole organisation and demonstrating the values of good governance through behaviour

- According to the organisation, what values guide its work?
- Does it follow these values in practice?
- What standards of behaviour should I expect?
- Do the senior people in the organisation put these standards of behaviour into practice?
- Do they put into practice the 'Nolan' principles for people in public life (selflessness, integrity, objectivity, accountability, openness, honesty and leadership)?

4. Good governance means taking informed, transparent decisions and managing risk

- Who is responsible for what kinds of decisions in the organisation?
- Can I easily find out what decisions have been taken and the reasons for them?
- Are the decisions based on up-to-date and complete information and good advice?
- Does the organisation publish a clear annual statement on the effectiveness of its risk management system?
- Does the organisation publish a clear annual account of how it makes sure that its policies are put into practice? Is the statement reassuring? How does it compare with my own experience?

5. Good governance means developing the capacity and capability of the governing body to be effective

- How does the organisation encourage people to get involved in running it?
- What support does it provide for people who do get involved?
- How does the organisation make sure that all those running the organisation are doing a good job?

6. Good governance means engaging stakeholders and making accountability real

- Can I easily get information to answer all these questions?
- Are there opportunities for me and other people to make our views known?
- Does the organisation publish an annual report containing its accounts for the year? Are copies freely available? Is the content informative?
- How do I find out what decisions were taken as a result of my and others' opinions being asked for?
- Are there opportunities to question the people in charge about their plans and decisions?
- Can I easily find out how to complain and who to contact with suggestions for changes?

APPENDIX 7

CIPFA The Chartered Institute of Public Finance & Accountancy

delivering good governance

in Local Government
Framework
2016 Edition

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TRI00000264_0191

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed. As the world's only professional accountancy body to specialise in public services, CIPFA's qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance.

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2016 Edition

solace

TRI00000264_0193

Published by:

CIPFA \ THE CHARTERED INSTITUTE OF PUBLIC FINANCE AND ACCOUNTANCY

77 Mansell Street, London E1 8AN

020 7543 5600 \ publications@cipfa.org \ www.cipfa.org

ISBN 978 1 84508 456 1

Designed and typeset by Ministry of Design, Bath (www.ministryofdesign.co.uk)

Acknowledgements

CIPFA and Solace have drawn together the following members of the Joint Working Group and are grateful to them and to their employing organisations for their time and assistance in preparing this *Delivering Good Governance in Local Government: Framework*.

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Contents

CHAPTER ONE

Introduction

1.1 Governance arrangements in the public services are keenly observed and sometimes criticised. Significant governance failings attract huge attention – as they should – and one significant failing can taint a whole sector. Local government organisations are big business and are vitally important to tax payers and service users. They need to ensure that they meet the highest standards and that governance arrangements are not only sound but are seen to be sound.

1.2 It is crucial that leaders and chief executives keep their governance arrangements up to date and relevant. The main principle underpinning the development of the new *Delivering Good Governance in Local Government: Framework* (CIPFA/Solace, 2016) ('the Framework') continues to be that local government is developing and shaping its own approach to governance, taking account of the environment in which it now operates. The Framework is intended to assist authorities individually in reviewing and accounting for their own unique approach. The overall aim is to ensure that resources are directed in accordance with agreed policy and according to priorities, that there is sound and inclusive decision making and that there is clear accountability for the use of those resources in order to achieve desired outcomes for service users and communities.

1.3 The Framework positions the attainment of sustainable economic, societal, and environmental outcomes as a key focus of governance processes and structures. Outcomes give the role of local government its meaning and importance, and it is fitting that they have this central role in the sector's governance. Furthermore, the focus on sustainability and the links between governance and public financial management are crucial – local authorities must recognise the need to focus on the long term. Local authorities have responsibilities to more than their current electors as they must take account of the impact of current decisions and actions on future generations.

CHAPTER TWO
Status

2.1 Section 3.7 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 notes:

Regulation 6(1)(a) of the Accounts and Audit Regulations 2015, Regulation 4(2) of the Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015, Regulation 5(2) of the Local Authority Accounts (Scotland) Regulations 2014 and Regulation 5(2) of the Accounts and Audit (Wales) Regulations 2014 require an authority to conduct a review at least once in a year of the effectiveness of its system of internal control and include a statement reporting on the review with any published Statement of Accounts (England) (as a part of the Annual Accounts (Scotland)). Regulation 6(1)(b) of the Accounts and Audit Regulations 2015, Regulation 4(4) of the Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015 and Regulation 5(4) of the Local Authority Accounts (Scotland) Regulations 2014 require that for a local authority in England, Northern Ireland and Scotland the statement is an Annual Governance Statement.

The preparation and publication of an Annual Governance Statement in accordance with Delivering Good Governance in Local Government: Framework (2016) would fulfil the statutory requirements across the United Kingdom for a local authority to conduct a review at least once in each financial year of the effectiveness of its system of internal control and to include a statement reporting on the review with its Statement of Accounts. In England the Accounts and Audit Regulations 2015 stipulate that the Annual Governance Statement must be "prepared in accordance with proper practices in relation to accounts". Therefore a local authority in England shall provide this statement in accordance with Delivering Good Governance in Local Government: Framework (2016) and this section of the Code.

2.2 This Framework applies to annual governance statements prepared for the financial year 2016/17 onwards.

CHAPTER THREE

Requirements

3.1 The Framework defines the principles that should underpin the governance of each local government organisation. It provides a structure to help individual authorities with their approach to governance. Whatever form of arrangements are in place, authorities should therefore test their governance structures and partnerships against the principles contained in the Framework by:

- reviewing existing governance arrangements
- developing and maintaining an up-to-date local code of governance, including arrangements for ensuring ongoing effectiveness
- reporting publicly on compliance with their own code on an annual basis and on how they have monitored the effectiveness of their governance arrangements in the year and on planned changes.

3.2 The term 'local code' essentially refers to the governance structure in place as there is an expectation that a formally set out local structure should exist, although in practice it may consist of a number of local codes or documents.

3.3 To achieve good governance, each local authority should be able to demonstrate that its governance structures comply with the core and sub-principles contained in this Framework. It should therefore develop and maintain a local code of governance/governance arrangements reflecting the principles set out.

3.4 It is also crucial that the Framework is applied in a way that demonstrates the spirit and ethos of good governance which cannot be achieved by rules and procedures alone. Shared values that are integrated into the culture of an organisation, and are reflected in behaviour and policy, are hallmarks of good governance.

CHAPTER FOUR

Applicability and terminology

APPLICABILITY

4.1 The Framework is for all parts of local government and its partnerships, including:

- county councils
- district, borough and city councils
- metropolitan and unitary councils
- the Greater London Authority and functional bodies
- combined authorities, city regions, devolved structures
- the City of London Corporation
- combined fire authorities
- joint authorities
- police authorities, which for these purposes since 2012 includes both the police and crime commissioner (PCC) and the chief constable
- national park authorities.

4.2 The Framework is applicable to a system involving a group of local government organisations as well as to each of them individually. The Framework principles are therefore intended to be relevant to all organisations and systems associated with local authorities, ie joint boards, partnerships and other vehicles through which authorities now work. However, a one-size-fits-all approach to governance is inappropriate. Not all parts of the Framework will be directly applicable to all types and size of such structures, and it is therefore up to different authorities and associated organisations to put the Framework into practice in a way that reflects their structures and is proportionate to their size.

TERMINOLOGY

4.3 The terms 'authorities', 'local government organisations' and 'organisations' are used throughout this Framework and should be taken to cover any partnerships and joint working arrangements in operation.

4.4 In the police service, where the accountabilities rest with designated individuals rather than a group of members, terms such as 'leader' should be interpreted as relating to the PCC or the chief constable as appropriate.

CHAPTER FIVE

Guidance notes

5.1 In recognition of the separate legislation applicable to different parts of local government, guidance notes to accompany the Framework have been developed for:

- local government in England (excluding police)
- local government in Wales (excluding police)
- police in England and Wales
- local government in Scotland.

5.2 The guidance notes, which should be used in conjunction with the Framework, are intended to assist authorities across their governance systems, structures and partnerships in reviewing their governance arrangements. It will also help them in interpreting the overarching principles and terminology contained in the Framework in a way that is appropriate for their governance structures, taking account of the legislative and constitutional arrangements that underpin them.

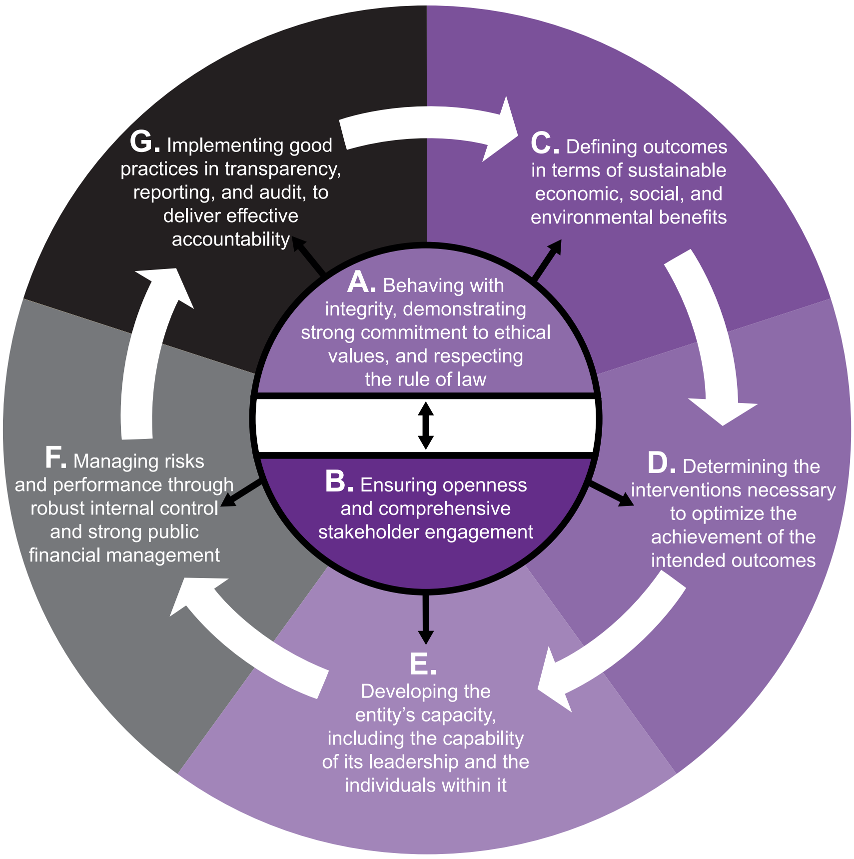
CHAPTER SIX

The principles of good governance – application

DEFINING THE CORE PRINCIPLES AND SUB-PRINCIPLES OF GOOD GOVERNANCE

6.1 The diagram below, taken from the International Framework: Good Governance in the Public Sector (CIPFA/IFAC, 2014) (the 'International Framework'), illustrates the various principles of good governance in the public sector and how they relate to each other.

Achieving the Intended Outcomes While Acting in the Public Interest at all Times



The International Framework notes that:

Principles A and B permeate implementation of principles C to G. The diagram also illustrates that good governance is dynamic, and that an entity as a whole should be committed to improving governance on a continuing basis through a process of evaluation and review.

DEFINING GOVERNANCE

6.2 The International Framework defines governance as follows:

Governance comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved.

The International Framework also states that:

To deliver good governance in the public sector, both governing bodies and individuals working for public sector entities must try to achieve their entity's objectives while acting in the public interest at all times.

Acting in the public interest implies primary consideration of the benefits for society, which should result in positive outcomes for service users and other stakeholders.

6.3 In local government, the governing body is the full council or authority. In the police, PCCs and chief constables are corporations sole and are jointly responsible for governance. The many references to 'members' in the tables which follow should be read in the context that the principles set out apply equally in the police.

PRINCIPLES OF GOOD GOVERNANCE IN LOCAL GOVERNMENT

6.4 The core principles and sub-principles of good governance set out in the table below are taken from the International Framework. In turn they have been interpreted for a local government context.

It is up to each local authority or local government organisation to:

- set out its commitment to the principles of good governance included in this Framework
- determine its own governance structure, or local code, underpinned by these principles
- ensure that it operates effectively in practice.

Core principles and sub-principles of good governance

Core principles (shown in bold)	Sub-principles (shown in bold)
Acting in the public interest requires a commitment to and effective arrangements for:	Behaviours and actions that demonstrate good governance in practice are illustrated in the bullet points.
A. Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law Local government organisations are accountable not only for how much they spend, but also for how they use the resources under their stewardship. This includes accountability for outputs, both positive and negative, and for the outcomes they have achieved. In addition, they have an overarching responsibility to serve the public interest in adhering to the requirements of legislation and government policies. It is essential that, as a whole, they can demonstrate the appropriateness of all their actions across all activities and have mechanisms in place to encourage and enforce adherence to ethical values and to respect the rule of law.	**Behaving with integrity** ■ Ensuring members and officers behave with integrity and lead a culture where acting in the public interest is visibly and consistently demonstrated thereby protecting the reputation of the organisation ■ Ensuring members take the lead in establishing specific standard operating principles or values for the organisation and its staff and that they are communicated and understood. These should build on the Seven Principles of Public Life (the Nolan Principles) ■ Leading by example and using the above standard operating principles or values as a framework for decision making and other actions ■ Demonstrating, communicating and embedding the standard operating principles or values through appropriate policies and processes which are reviewed on a regular basis to ensure that they are operating effectively **Demonstrating strong commitment to ethical values** ■ Seeking to establish, monitor and maintain the organisation's ethical standards and performance ■ Underpinning personal behaviour with ethical values and ensuring they permeate all aspects of the organisation's culture and operation ■ Developing and maintaining robust policies and procedures which place emphasis on agreed ethical values ■ Ensuring that external providers of services on behalf of the organisation are required to act with integrity and in compliance with ethical standards expected by the organisation

Core principles (shown in bold)	Sub-principles (shown in bold)
	Respecting the rule of law ■ Ensuring members and staff demonstrate a strong commitment to the rule of the law as well as adhering to relevant laws and regulations ■ Creating the conditions to ensure that the statutory officers, other key post holders, and members, are able to fulfil their responsibilities in accordance with legislative and regulatory requirements ■ Striving to optimise the use of the full powers available for the benefit of citizens, communities and other stakeholders ■ Dealing with breaches of legal and regulatory provisions effectively ■ Ensuring corruption and misuse of power are dealt with effectively
B. Ensuring openness and comprehensive stakeholder engagement Local government is run for the public good, organisations therefore should ensure openness in their activities. Clear, trusted channels of communication and consultation should be used to engage effectively with all groups of stakeholders, such as individual citizens and service users, as well as institutional stakeholders.	**Openness** ■ Ensuring an open culture through demonstrating, documenting and communicating the organisation's commitment to openness ■ Making decisions that are open about actions, plans, resource use, forecasts, outputs and outcomes. The presumption is for openness. If that is not the case, a justification for the reasoning for keeping a decision confidential should be provided ■ Providing clear reasoning and evidence for decisions in both public records and explanations to stakeholders and being explicit about the criteria, rationale and considerations used. In due course, ensuring that the impact and consequences of those decisions are clear ■ Using formal and informal consultation and engagement to determine the most appropriate and effective interventions/ courses of action **Engaging comprehensively with institutional stakeholders** NB institutional stakeholders are the other organisations that local government needs to work with to improve services and outcomes (such as commercial partners and suppliers as well as other public or third sector organisations) or organisations to which they are accountable. ■ Effectively engaging with institutional stakeholders to ensure that the purpose, objectives and intended outcomes for each stakeholder relationship are clear so that outcomes are achieved successfully and sustainably

Core principles (shown in bold)	Sub-principles (shown in bold)
	■ Developing formal and informal partnerships to allow for resources to be used more efficiently and outcomes achieved more effectively ■ Ensuring that partnerships are based on: – trust – a shared commitment to change – a culture that promotes and accepts challenge among partners and that the added value of partnership working is explicit **Engaging with individual citizens and service users effectively** ■ Establishing a clear policy on the type of issues that the organisation will meaningfully consult with or involve communities, individual citizens, service users and other stakeholders to ensure that service (or other) provision is contributing towards the achievement of intended outcomes ■ Ensuring that communication methods are effective and that members and officers are clear about their roles with regard to community engagement ■ Encouraging, collecting and evaluating the views and experiences of communities, citizens, service users and organisations of different backgrounds including reference to future needs ■ Implementing effective feedback mechanisms in order to demonstrate how views have been taken into account ■ Balancing feedback from more active stakeholder groups with other stakeholder groups to ensure inclusivity ■ Taking account of the impact of decisions on future generations of tax payers and service users

Principles (shown in bold)	Sub-principles (shown in bold)
In addition to the overarching requirements for acting in the public interest in principles A and B, achieving good governance also requires a commitment to and effective arrangements for:	Behaviours and actions that demonstrate good governance in practice are illustrated in the bullet points.
C. Defining outcomes in terms of sustainable economic, social, and environmental benefits The long-term nature and impact of many of local government's responsibilities mean that it should define and plan outcomes and that these should be sustainable. Decisions should further the organisation's purpose, contribute to intended benefits and outcomes, and remain within the limits of authority and resources. Input from all groups of stakeholders, including citizens, service users, and institutional stakeholders, is vital to the success of this process and in balancing competing demands when determining priorities for the finite resources available.	**Defining outcomes** ■ Having a clear vision, which is an agreed formal statement of the organisation's purpose and intended outcomes containing appropriate performance indicators, which provide the basis for the organisation's overall strategy, planning and other decisions ■ Specifying the intended impact on, or changes for, stakeholders including citizens and service users. It could be immediately or over the course of a year or longer ■ Delivering defined outcomes on a sustainable basis within the resources that will be available ■ Identifying and managing risks to the achievement of outcomes ■ Managing service users' expectations effectively with regard to determining priorities and making the best use of the resources available **Sustainable economic, social and environmental benefits** ■ Considering and balancing the combined economic, social and environmental impact of policies and plans when taking decisions about service provision ■ Taking a longer-term view with regard to decision making, taking account of risk and acting transparently where there are potential conflicts between the organisation's intended outcomes and short-term factors such as the political cycle or financial constraints ■ Determining the wider public interest associated with balancing conflicting interests between achieving the various economic, social and environmental benefits, through consultation where possible, in order to ensure appropriate trade-offs ■ Ensuring fair access to services

Principles (shown in bold)	Sub-principles (shown in bold)
D. Determining the interventions necessary to optimise the achievement of the intended outcomes Local government achieves its intended outcomes by providing a mixture of legal, regulatory, and practical interventions (courses of action). Determining the right mix of these courses of action is a critically important strategic choice that local government has to make to ensure intended outcomes are achieved. They need robust decision-making mechanisms to ensure that their defined outcomes can be achieved in a way that provides the best trade-off between the various types of resource inputs while still enabling effective and efficient operations. Decisions made need to be reviewed frequently to ensure that achievement of outcomes is optimised.	**Determining interventions** ■ Ensuring decision makers receive objective and rigorous analysis of a variety of options indicating how intended outcomes would be achieved and associated risks. Therefore ensuring best value is achieved however services are provided ■ Considering feedback from citizens and service users when making decisions about service improvements or where services are no longer required in order to prioritise competing demands within limited resources available including people, skills, land and assets and bearing in mind future impacts **Planning interventions** ■ Establishing and implementing robust planning and control cycles that cover strategic and operational plans, priorities and targets ■ Engaging with internal and external stakeholders in determining how services and other courses of action should be planned and delivered ■ Considering and monitoring risks facing each partner when working collaboratively, including shared risks ■ Ensuring arrangements are flexible and agile so that the mechanisms for delivering goods and services can be adapted to changing circumstances ■ Establishing appropriate key performance indicators (KPIs) as part of the planning process in order to identify how the performance of services and projects is to be measured ■ Ensuring capacity exists to generate the information required to review service quality regularly ■ Preparing budgets in accordance with objectives, strategies and the medium term financial plan ■ Informing medium and long term resource planning by drawing up realistic estimates of revenue and capital expenditure aimed at developing a sustainable funding strategy

Principles (shown in bold)	Sub-principles (shown in bold)
	Optimising achievement of intended outcomes ■ Ensuring the medium term financial strategy integrates and balances service priorities, affordability and other resource constraints ■ Ensuring the budgeting process is all-inclusive, taking into account the full cost of operations over the medium and longer term ■ Ensuring the medium term financial strategy sets the context for ongoing decisions on significant delivery issues or responses to changes in the external environment that may arise during the budgetary period in order for outcomes to be achieved while optimising resource usage ■ Ensuring the achievement of 'social value' through service planning and commissioning
E. Developing the entity's capacity, including the capability of its leadership and the individuals within it Local government needs appropriate structures and leadership, as well as people with the right skills, appropriate qualifications and mindset, to operate efficiently and effectively and achieve intended outcomes within the specified periods. A local government organisation must ensure that it has both the capacity to fulfil its own mandate and to make certain that there are policies in place to guarantee that its management has the operational capacity for the organisation as a whole. Because both individuals and the environment in which an organisation operates will change over time, there will be a continuous need to develop its capacity as well as the skills and experience of individual staff members. Leadership in local government is strengthened by the participation of people with many different types of backgrounds, reflecting the structure and diversity of communities.	**Developing the entity's capacity** ■ Reviewing operations, performance and use of assets on a regular basis to ensure their continuing effectiveness ■ Improving resource use through appropriate application of techniques such as benchmarking and other options in order to determine how resources are allocated so that defined outcomes are achieved effectively and efficiently ■ Recognising the benefits of partnerships and collaborative working where added value can be achieved ■ Developing and maintaining an effective workforce plan to enhance the strategic allocation of resources **Developing the capability of the entity's leadership and other individuals** ■ Developing protocols to ensure that elected and appointed leaders negotiate with each other regarding their respective roles early on in the relationship and that a shared understanding of roles and objectives is maintained ■ Publishing a statement that specifies the types of decisions that are delegated and those reserved for the collective decision making of the governing body ■ Ensuring the leader and the chief executive have clearly defined and distinctive leadership roles within a structure whereby the chief executive leads in implementing strategy and managing the delivery of services and other outputs set by members and each provides a check and a balance for each other's authority

Principles (shown in bold)	Sub-principles (shown in bold)
	■ Developing the capabilities of members and senior management to achieve effective leadership and to enable the organisation to respond successfully to changing legal and policy demands as well as economic, political and environmental changes and risks by: – ensuring members and staff have access to appropriate induction tailored to their role and that ongoing training and development matching individual and organisational requirements is available and encouraged – ensuring members and officers have the appropriate skills, knowledge, resources and support to fulfil their roles and responsibilities and ensuring that they are able to update their knowledge on a continuing basis – ensuring personal, organisational and system-wide development through shared learning, including lessons learnt from governance weaknesses both internal and external ■ Ensuring that there are structures in place to encourage public participation ■ Taking steps to consider the leadership's own effectiveness and ensuring leaders are open to constructive feedback from peer review and inspections ■ Holding staff to account through regular performance reviews which take account of training or development needs ■ Ensuring arrangements are in place to maintain the health and wellbeing of the workforce and support individuals in maintaining their own physical and mental wellbeing

Principles (shown in bold)	Sub-principles (shown in bold)
F. Managing risks and performance through robust internal control and strong public financial management Local government needs to ensure that the organisations and governance structures that it oversees have implemented, and can sustain, an effective performance management system that facilitates effective and efficient delivery of planned services. Risk management and internal control are important and integral parts of a performance management system and are crucial to the achievement of outcomes. Risk should be considered and addressed as part of all decision making activities. A strong system of financial management is essential for the implementation of policies and the achievement of intended outcomes, as it will enforce financial discipline, strategic allocation of resources, efficient service delivery and accountability. It is also essential that a culture and structure for scrutiny are in place as a key part of accountable decision making, policy making and review. A positive working culture that accepts, promotes and encourages constructive challenge is critical to successful scrutiny and successful service delivery. Importantly, this culture does not happen automatically, it requires repeated public commitment from those in authority.	**Managing risk** ▪ Recognising that risk management is an integral part of all activities and must be considered in all aspects of decision making ▪ Implementing robust and integrated risk management arrangements and ensuring that they are working effectively ▪ Ensuring that responsibilities for managing individual risks are clearly allocated **Managing performance** ▪ Monitoring service delivery effectively including planning, specification, execution and independent post implementation review ▪ Making decisions based on relevant, clear objective analysis and advice pointing out the implications and risks inherent in the organisation's financial, social and environmental position and outlook ▪ Ensuring an effective scrutiny or oversight function is in place which provides constructive challenge and debate on policies and objectives before, during and after decisions are made thereby enhancing the organisation's performance and that of any organisation for which it is responsible (Or, for a committee system) Encouraging effective and constructive challenge and debate on policies and objectives to support balanced and effective decision making ▪ Providing members and senior management with regular reports on service delivery plans and on progress towards outcome achievement ▪ Ensuring there is consistency between specification stages (such as budgets) and post implementation reporting (eg financial statements)

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Principles (shown in bold)	Sub-principles (shown in bold)
	Robust internal control ■ Aligning the risk management strategy and policies on internal control with achieving objectives ■ Evaluating and monitoring risk management and internal control on a regular basis ■ Ensuring effective counter fraud and anti-corruption arrangements are in place ■ Ensuring additional assurance on the overall adequacy and effectiveness of the framework of governance, risk management and control is provided by the internal auditor ■ Ensuring an audit committee or equivalent group/ function, which is independent of the executive and accountable to the governing body: – provides a further source of effective assurance regarding arrangements for managing risk and maintaining an effective control environment – that its recommendations are listened to and acted upon **Managing data** ■ Ensuring effective arrangements are in place for the safe collection, storage, use and sharing of data, including processes to safeguard personal data ■ Ensuring effective arrangements are in place and operating effectively when sharing data with other bodies ■ Reviewing and auditing regularly the quality and accuracy of data used in decision making and performance monitoring **Strong public financial management** ■ Ensuring financial management supports both long term achievement of outcomes and short-term financial and operational performance ■ Ensuring well-developed financial management is integrated at all levels of planning and control, including management of financial risks and controls

Principles (shown in bold)	Sub-principles (shown in bold)
G. Implementing good practices in transparency, reporting, and audit to deliver effective accountability Accountability is about ensuring that those making decisions and delivering services are answerable for them. Effective accountability is concerned not only with reporting on actions completed, but also ensuring that stakeholders are able to understand and respond as the organisation plans and carries out its activities in a transparent manner. Both external and internal audit contribute to effective accountability.	**Implementing good practice in transparency** ■ Writing and communicating reports for the public and other stakeholders in a fair, balanced and understandable style appropriate to the intended audience and ensuring that they are easy to access and interrogate ■ Striking a balance between providing the right amount of information to satisfy transparency demands and enhance public scrutiny while not being too onerous to provide and for users to understand **Implementing good practices in reporting** ■ Reporting at least annually on performance, value for money and stewardship of resources to stakeholders in a timely and understandable way ■ Ensuring members and senior management own the results reported ■ Ensuring robust arrangements for assessing the extent to which the principles contained in this Framework have been applied and publishing the results on this assessment, including an action plan for improvement and evidence to demonstrate good governance (the annual governance statement) ■ Ensuring that this Framework is applied to jointly managed or shared service organisations as appropriate ■ Ensuring the performance information that accompanies the financial statements is prepared on a consistent and timely basis and the statements allow for comparison with other, similar organisations **Assurance and effective accountability** ■ Ensuring that recommendations for corrective action made by external audit are acted upon ■ Ensuring an effective internal audit service with direct access to members is in place, providing assurance with regard to governance arrangements and that recommendations are acted upon ■ Welcoming peer challenge, reviews and inspections from regulatory bodies and implementing recommendations ■ Gaining assurance on risks associated with delivering services through third parties and that this is evidenced in the annual governance statement ■ Ensuring that when working in partnership, arrangements for accountability are clear and the need for wider public accountability has been recognised and met

CHAPTER SEVEN

Annual review and reporting

THE ANNUAL GOVERNANCE STATEMENT

7.1 Local authorities are required to prepare an annual governance statement (see Chapter two) in order to report publicly on the extent to which they comply with their own code of governance, which in turn is consistent with the good governance principles in this Framework. This includes how they have monitored and evaluated the effectiveness of their governance arrangements in the year, and on any planned changes in the coming period. The process of preparing the governance statement should itself add value to the effectiveness of the governance and internal control framework.

7.2 The annual governance statement is a valuable means of communication. It enables an authority to explain to the community, service users, tax payers and other stakeholders its governance arrangements and how the controls it has in place manage risks of failure in delivering its outcomes. It should reflect an individual authority's particular features and challenges.

7.3 The annual governance statement should provide a meaningful but brief communication regarding the review of governance that has taken place, including the role of the governance structures involved (such as the authority, the audit and other committees). It should be high level, strategic and written in an open and readable style.

7.4 The annual governance statement should be focused on outcomes and value for money and relate to the authority's vision for the area. It should provide an assessment of the effectiveness of the authority's governance arrangements in supporting the planned outcomes – not simply a description of them. Key elements of an authority's governance arrangements are summarised in the next section.

7.5 The annual governance statement should include:

- an acknowledgement of responsibility for ensuring that there is a sound system of governance (incorporating the system of internal control) and reference to the authority's code of governance
- reference to and assessment of the effectiveness of key elements of the governance framework and the role of those responsible for the development and maintenance of the governance environment, such as the authority, the executive, the audit committee, internal audit and others as appropriate
- an opinion on the level of assurance that the governance arrangements can provide and that the arrangements continue to be regarded as fit for purpose in accordance with the governance framework

- an agreed action plan showing actions taken, or proposed, to deal with significant governance issues
- reference to how issues raised in the previous year's annual governance statement have been resolved
- a conclusion – a commitment to monitoring implementation as part of the next annual review.

7.6 The annual governance statement should be signed by the leading member (or equivalent) and chief executive (or equivalent) on behalf of the authority.

7.7 The annual governance statement should be approved at a meeting of the authority or delegated committee (in Scotland, the authority or a committee with a remit including audit or governance).

7.8 Local authorities are required to include the annual governance statement with their statement of accounts. As the annual governance statement provides a commentary on all aspects of the authority's performance, it is appropriate for it to be published, either in full or as a summary, in the annual report, where one is published. It is important that it is kept up to date at time of publication.

GOVERNANCE ARRANGEMENTS

7.9 Key elements of the structures and processes that comprise an authority's governance arrangements are summarised below. They do not need to be described in detail in the annual governance statement if they are already easily accessible by the public, for example through the authority's code of governance.

- Developing codes of conduct which define standards of behaviour for members and staff, and policies dealing with whistleblowing and conflicts of interest and that these codes and policies are communicated effectively.
- Ensuring compliance with relevant laws and regulations, internal policies and procedures, and that expenditure is lawful.
- Documenting a commitment to openness and acting in the public interest.
- Establishing clear channels of communication with all sections of the community and other stakeholders, ensuring accountability and encouraging open consultation.
- Developing and communicating a vision which specifies intended outcomes for citizens and service users and is used as a basis for planning.
- Translating the vision into courses of action for the authority, its partnerships and collaborations.
- Reviewing the effectiveness of the decision-making framework, including delegation arrangements, decision-making in partnerships, information provided to decision makers and robustness of data quality.
- Measuring the performance of services and related projects and ensuring that they are delivered in accordance with defined outcomes and that they represent the best use of resources and value for money.

- Defining and documenting the roles and responsibilities of members and management, with clear protocols for effective communication in respect of the authority and partnership arrangements.
- Ensuring that financial management arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer in Local Government (2015) or CIPFA Statement on the Role of the Chief Financial Officer of the Police and Crime Commissioner and the Chief Financial Officer of the Chief Constable (2014) as appropriate and, where they do not, explain why and how they deliver the same impact.
- Ensuring effective arrangements are in place for the discharge of the monitoring officer function.
- Ensuring effective arrangements are in place for the discharge of the head of paid service function.
- Providing induction and identifying the development needs of members and senior officers in relation to their strategic roles, supported by appropriate training.
- Reviewing the effectiveness of the framework for identifying and managing risks and for performance and demonstrating clear accountability.
- Ensuring effective counter fraud and anti-corruption arrangements are developed and maintained in accordance with the Code of Practice on Managing the Risk of Fraud and Corruption (CIPFA, 2014).
- Ensuring an effective scrutiny function is in place.
- Ensuring that assurance arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Head of Internal Audit (2010) and, where they do not, explain why and how they deliver the same impact.
- Undertaking the core functions of an audit committee, as identified in Audit Committees: Practical Guidance for Local Authorities and Police (CIPFA, 2013).
- Ensuring that the authority provides timely support, information and responses to external auditors and properly considers audit findings and recommendations.
- Incorporating good governance arrangements in respect of partnerships and other joint working and ensuring that they are reflected across the authority's overall governance structures.

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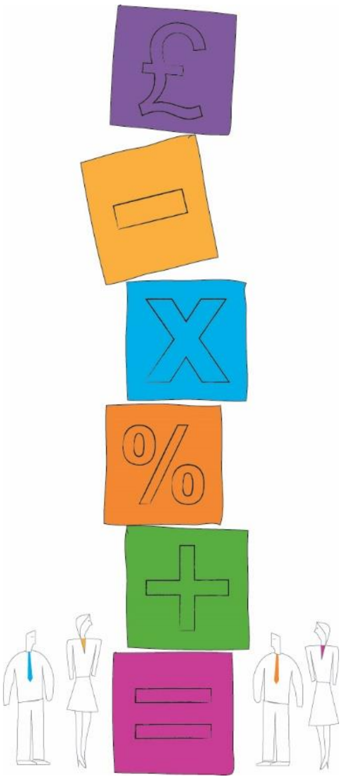

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