The Highland Council

Resources Committee – 27 May 2015

Agenda Item	**13(b)**
Report No	**RES/ 40/15**

Audit Scotland – Major Capital Investments in Councils: A Follow-up Report

Report by Director of Finance

Summary

This report considers the key issues arising from this national report, highlights the main issues for Highland Council to consider, and recommends improvements to existing practice.

1. Background

1.1 This report was considered by the Audit & Scrutiny Committee at its meeting on 26 March 2015 and its findings are brought to this committee for further consideration.

1.2 The report is a follow-up to the previous report that was considered by this Committee at its meeting on 5 June 2013. Whilst presented as a follow-up national report, the Audit Scotland report does introduce new issues that are specific to the Highland Council.

1.3 This report therefore considers the Action Plan and provides a more detailed appraisal of the issues raised by Audit Scotland, and the Council's response to these.

2. Discussion

2.1 The Council produces a summary capital budget monitoring statement on a quarterly basis to each meeting of this Committee. This provides a high level summary of service expenditure against budget, and highlights any significant variation. In addition, detailed reports are submitted on a similar frequency to the relevant Policy Committee.

2.2 Unlike the Revenue Budget, where judgements can be made about the forecast year end position based on previous analysis and year to date expenditure, capital monitoring is heavily reliant on professional advice of project managers on anticipated spend within the financial year.

2.3 Like most public sector bodies, the Council has experienced significant slippage in projects in most financial years. This can be due to a range of factors, including planning issues, contractual delays, optimistic assumptions over start and end dates.

2.4 To address some of these issues, the Council has intentionally overcommitted expenditure on its funded capital programme in each of the last two financial years by 10%. This has proved to be a successful tactic to maximise expenditure against the borrowing available to finance the programme, and supports the local economy through this higher level of capital investment.

2.5 In financial terms, slippage in the delivery of the capital programme is not necessary a bad thing. Slippage has resulted in one-off revenue savings in Treasury Management as a result of borrowing being lower than estimated. These savings have been used for a range of purposes, including additional funding for roads maintenance.

2.6 However slippage can carry a longer term risk of increased revenue cost should the cost of borrowing increase through higher interest rates. This has not been an issue in recent years however.

2.7 The current process of budgetary control over the Capital Programme has been satisfactory and ensured proper financial control over the Capital Programme. There is absolutely no risk to the statutory responsibility to ensure that the Council has adequate systems for the proper administration of its financial affairs.

3. Major Capital Projects

3.1 The Council's financial reporting focusses on the current financial year and the budget is set to reflect planned expenditure in that year. This ensures proper linkage between capital plans, and affordability through borrowing costs charged to the revenue budget.

3.2 While this is satisfactory for the significant proportion of the Capital Plan what the current process does not do is look at major projects which cover more than one financial year and monitor over the whole life of the project. Each major project has its planned expenditure broken down to the appropriate financial year, and is monitored on that basis.

3.3 What the Audit Scotland report highlights, and this is acknowledged by Officers, is that there is no reporting to Committee on the final position to answer three key questions:-

- Was the project delivered on time?
- Was the project delivered on budget?
- Did the project deliver the intended outcomes?

3.4 It is unrealistic and unnecessary to report on this basis for every capital project, but the report suggests a de minimis figure of £5m. Audit & Scrutiny Committee agreed to amend Financial Regulations to make this a requirement for each major project, and this was ratified by the Highland Council at its meeting on 14 May.

3.5 It should be stressed, that through existing monitoring, all significant variations resulting in slippage, or cost overruns, have been fully and appropriately reported to the relevant Policy Committee and Resources Committee.

3.6 The proposed change does however represent an improvement in current reporting and project governance.

4. Business Cases

4.1 The Council, for some years has operated a very successful process to assess all new applications for capital funding. Each proposal goes through a cross service officer group and is evaluated against a range of financial and non-financial criteria and a “score” produced. The higher scored projects are submitted to the Highland Council for addition to the Capital Plan. There is no member involvement at the evaluation stage.

4.2 For the vast majority of capital projects the current process is more than adequate to ensure consistency of approach to the consideration of new bids. The process does not differentiate between the scale and nature of different projects.

4.3 What the Audit Scotland report has highlighted, and is an issue that the Council has experienced with Westlink, is a need to review business cases where there is a significant lead in time from the evaluation stage to the delivery of the project.

4.4 The experience with Westlink has highlighted that, even where there has been no change to the project itself, cost assessments should be updated at a more regular basis. The original assessment of all options for Westlink were based at current prices, and whilst this allowed a consistent evaluation of all options, it should have ensured that the capital budget was updated for project inflation.

4.5 The Capital Plan has to reflect the affordability of the overall plan linked to the Council’s Revenue Budget through borrowing costs. Over the last 2 years there has been a significant change to the funding of the schools programme, with changes to the funding mechanism for Inverness Royal Academy, Wick Schools, and Tain. The discussions with the Scottish Futures Trust and delays in reaching financial close on the Wick Schools Project, has had a significant bearing on officers’ ability to update the Capital Plan. This has been highlighted to members on various occasions over the last twelve months.

4.6 Officers however acknowledge that progress on all significant capital projects, above £5m in value, should be reported on a regular basis, and this change will be implemented immediately.

5. Member Training

5.1 The Audit Scotland report makes reference to the need for member training on capital investment and appraisal. Previous training has been provided on capital expenditure, including funding and definitions. In addition, training has been provided on treasury management, which includes the questions of funding and affordability of the capital programme.

5.2 At the last meeting of this Committee, members asked for further training on treasury management, and officers will ensure that this training includes appropriate coverage of the important link between capital investment, appraisal and evaluation, and affordability and funding.

5.3 This training will also use the “Good Practice Checklist” for members that formed part of the original Audit Scotland Report.

6. Conclusions

6.1 The Council has sound systems and procedures in place to ensure the proper administration of its financial affairs, and does this through regular reports to the relevant Committees of the Council. These reports always make reference to any slippage or cost overrun.

6.2 The Audit Scotland report focusses on significant projects over a value of £5m, and officers agree that an additional approach is required to supplement the information and controls already in place. In future all projects of over £5m will be reported, in addition to existing annual monitoring, on a whole life basis and will also be the subject of a post contract evaluation.

6.3 These improvements are an important enhancement to existing practice and will provide members with greater scrutiny over these major projects.

7. Implications

7.1 Resource implications are highlighted within the report.

7.2 There are no specific legal, risk, equalities, climate change/Carbon Clever, Gaelic or rural implications to highlight.

Recommendations

The Committee is asked to:-

1. Consider the Audit Scotland Report and the management responses and proposed actions.

2. Note the proposed enhancements to existing policy and practice:-
    - Regular reporting, on a whole life basis, of all major projects over a value of £5m
    - Submission of a project evaluation at the end of each major project over the value of £5m
    - Inflation provision to be made for all significant projects where there is a time gap between evaluation and completion.

3. Note the proposed training programme for members.

Designation: Director of Finance

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