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Circular 22/06

Minute of the Minister for Finance on response to the 2002 Interim Report of the Committee of Public Accounts on Transport

A Chara

I am directed by the Minister for Finance to enclose for your information and guidance a copy of the Minute of the Minister for Finance on response to the 2002 Interim Report of the Committee of Public Accounts on Transport.

Your attention is drawn in particular to the following items, in Part 1 of the Minute:

- the need for Accounting Officers to ensure that basic financial control procedures are in place in their Departments/Offices and are operating properly, and that arrangements are in place to inform them of any significant lapses in such procedures;
- the views of the Committee regarding the maintenance of financial control systems during periods of major structural change and during periods of transition in the implementation of new financial information systems; and the need to ensure that appropriately–trained staff are deployed in key financial control functions; and
- the need to ensure that the cost of financial monitoring and control activities in their Departments/Offices is monitored and to ensure appropriate effectiveness in these activities.

Mise le meas

Noel T. O'Gorman
Second Secretary General

To: All Accounting Officers

Minute of the Minister for Finance
on the 2002 Interim Report of the of Public Accounts Committee
on Transport

The Minister for Finance has examined the Committee's 2002 Interim Report on Transport and has taken account of its findings. In relation to the Committee's recommendations, his response is as follows:

1. Department of Transport - Financial Control Weaknesses

- **Secretaries General should be kept aware of any lapses in basic control procedures, such as the reconciliation of PMG and all other bank accounts.**

The Minister for Finance accepts this recommendation and his Department will write to all Accounting Officers reminding them of the need to ensure that basic financial control procedures are in place in their Departments/Offices and are operating properly, and that arrangements are in place to inform them of any significant lapses in such procedures.

- **The Committee of Public Accounts supports the development of audit committees in all Government Departments.**

The Minister welcomes the support of the Committee on this matter. The Report of the Working Group on the Accountability of Secretaries General and Accounting Officers (the Mullarkey Report) recommended, inter alia, that there be a formally-constituted Audit Committee in each Department/Office (or, in the case of smaller Offices, that there is suitable access to such a Committee.). This recommendation has been implemented in Departments and Offices.

- **The Department of Finance should produce guidance on the maintenance of financial control systems during periods of major structural change and during periods of transition in the implementation of new financial information systems. Staff retention in key financial control functions should be emphasised.**

The Minister has asked his Department to draw the attention of Accounting Officers to the views of the Committee in this context. He notes that the installation of modern financial management systems is now complete in all Departments and Offices. He is satisfied that Departments are already keenly aware of the need to ensure that financial control systems are maintained at all times and that appropriately trained staff are deployed in key financial control functions.

- **The Department of Finance should develop performance indicators for the cost of financial monitoring and control activities in Departments and should monitor these indicators.**

The Minister would point out that, as the Committee itself recognised, the cost of financial monitoring and control will vary with the size of a Department or Office, the degree of risk involved, etc. In the circumstances the Minister does not propose that his Department engage in construction of performance indicators but will, instead, write to all Accounting Officers to remind them of the need to ensure that the cost of financial monitoring and control activities in their Departments/Offices is monitored and to ensure appropriate effectiveness in these activities.

In addition, the Minister notes that the modern financial management systems now installed in Departments / Offices provide managers with much fuller information on the costs associated with their various operations. Costs are already monitored by the Department of Finance in the context of Administrative Budgets.

2. Vote 32: Department of Transport

- **The Department, as a matter of urgency, should bring forward proposals to improve the management of the driver testing service so that the target waiting times for a driving test can be met.**

The Minister for Finance notes that the development of policy regarding driver testing is a matter for the Minister for Transport. The Road Safety Authority (RSA) is in the process of being established by the Department of Transport, following a Government decision in 2005 which approved the bringing together in one authority of all activities in the areas of driver testing, vehicle standards and the promotion of road safety. The legislation establishing the RSA has been passed since 31 May, 2006. The Department of Transport have advised that vesting day for the RSA is expected in September, 2006.

The Department of Transport proposed a package of measures in 2005 to help address the driving test backlog. These included short-term recruitment of former Driver Testers, redeployment of surplus staff from the Department of Agriculture, a bonus scheme for existing staff and outsourcing. The proposal to outsource a limited number of driving tests was found not to be in accordance with the terms of the Sustaining Progress Social Partnership Agreement on technical grounds by an arbitration hearing. However, following further discussions at mediation, agreement has now been reached with IMPACT for the outsourcing of up to 45,000 tests.

- **The Department and the NRA should report specifically on the value for money obtained from the new PPP arrangements.**

The Minister is assured by the Department of Transport that the PPP form of procurement is used in the National Roads Programme only where it clearly offers value for money. The assessment and evaluation of individual national road PPP projects, including from a value for money point of view, is undertaken by the NRA as an integral part of the planning of projects in accordance with Department of Finance Guidelines on the Appraisal and Management of Capital Projects and Working Rules for Cost Benefit Analysis. The development and implementation of PPP projects also take account of Department of Finance Interim Guidelines on the Assessment, Approval and Procurement of PPP projects.

The Minister is informed by the Department of Transport that, in assessing the value for money of a PPP project, the NRA, in line with the Department of Finance PPP guidelines, prepares a Financial Comparator (Public Sector Benchmark) which represents the cost of procuring the road project using traditional procurement. This is compared to the cost to the public sector of the project under a PPP arrangement, in order to assess which offers better value for money. This value-for-money comparison is undertaken at different stages of the PPP procurement process. At the final stage the bid which has been judged most economically advantageous is compared against the Financial Comparator to confirm that a PPP offers better value for money.

However, as noted by the Comptroller and Auditor General in his Report on Value for Money Examination of the Grouped Schools Pilot Partnership Project, “ultimately, the value for money…can only be determined…over the life of the contract.”

The Minister is assured by the Department of Transport that all documentation and evaluations held by the NRA relating to its PPP projects are fully available for review by the Comptroller and Auditor General.

- **More transparency on the funding rate of return implicit in the new PPP arrangements is needed to confirm value for money to the taxpayer.**

and

- **The Department of Finance should consider how effective parliamentary oversight of PPPs can best be secured and report on this to the Committee of Public Accounts.** *(This recommendation is No. 8 – Page 49 of PAC Report and is answered here in conjunction with the above recommendation)*

The Minister would point out that while the rates of return on private sector equity financing are a component in assessing the overall PPP package, the key determinant of value for money for the taxpayer in a particular case is the Public Sector Benchmark, i.e. the whole-life cost to the public sector of procuring the project traditionally, including State financing and retaining all the risks. In line with the Department of Finance Interim Guidelines on PPP projects, all such projects are assessed at preferred bidder stage from a value for money standpoint against a Public Sector Benchmark which is calculated for each project.

As regards Parliamentary oversight of PPPs, the Minister notes the oversight on individual Ministerial portfolios exercised by the relevant Select Committees of the House, who may examine all issues within the ambit of Ministers. In addition, he notes the current powers of the Committee as set out in legislation and in its terms of reference. He also notes that all PPP projects are subject to examination by the Comptroller and Auditor General.

All documentation held by State authorities entering into PPP projects is fully available for review by the Comptroller and Auditor General for reporting by him, as appropriate, whether these relate to PPP projects funded by Exchequer unitary payments or projects funded by user charges. Arrangements for VFM examinations by the Comptroller and Auditor General have provided access to a substantial amount of relevant information, including the financial model used by the winning bidder in the PPP arrangement. The financial model includes the discounted cash flows for the project, based on the risk transfer to the private sector consortium reflected in the project contract and also includes information on the internal rates of return on private sector investment in the project. This access is illustrated by the VFM report on the Bundled Schools project.

The Select Committees of the House and the Public Accounts Committee can request documentation from State authorities in the course of its proceedings and the Minister expects that authorities would respond positively to such requests, addressing, where relevant, considerations of commercial sensitivity or confidentiality and of legal professional privilege.

Expenditure in relation to PPPs remunerated by unitary payments is presented in a separate Subhead in the Estimates, which facilitates consideration by the relevant

Select Committee. These are in turn accounted for in the relevant Appropriation Accounts and the relevant Accounting Officer may be required to give evidence to the Committee in relation to these.

The Minister is satisfied that these arrangements are adequate to facilitate Parliamentary oversight of PPPs.

- **The full economic cost should be taken into account before the sponsoring Department finalises the specifications of projects.**

The Minister agrees that sponsoring Departments and agencies need to carry out proper appraisal of all capital investment proposals. To assist them in this regard, the Department of Finance revised its "Guidelines for the Appraisal and Management of Capital Expenditure Proposals in the Public Sector" in early 2005 and circulated the revised Guidelines to all Departments.

The Guidelines require that all investment proposals must be appraised and that the depth of the appraisal should be proportionate to the value of the project. A single appraisal is generally appropriate for projects costing between €0.5m and €5m. Larger projects, costing up to €30m, require at least a Multi-Criteria Analysis (MCA), which includes financial appraisal and also establishes preferences between project options by reference to an explicit set of objectives and measurable criteria. The sponsoring authority specifically is required to carry out a full Cost Benefit Analysis (CBA) for projects costing over €30 million, or for other projects such as those that are especially complex or innovative.

The Guidelines also provide that a project should proceed to the tendering stage only if it is in line with the project that was approved in principle following appraisal; if there is a change in the project specifications, the Guidelines require that the proposal be reviewed and the project be either abandoned or amended and resubmitted for approval in principle.

In the case of the National Roads Programme, the Minister is assured by the Department of Transport that, regardless of the form of contract used – whether it be traditional procurement, Design/Build, or PPP – all major national road projects are subject to comprehensive assessment and evaluation from a transport, economic and environmental perspective. This is done by the NRA as an integral part of the planning of projects, and in accordance with Department of Finance Guidelines on the Appraisal and Management of Capital Projects and, in the case of PPP projects, the Department of Finance Interim Guidelines on the Assessment, Approval and Procurement of PPP projects.

3. Special Report No. 6 - Department of Transport – National Roads Authority Primary Routes Improvement Scheme

- **There is a need for a better capacity to produce more accurate cost forecasts for the Roads Programme. The Departments of Finance and Transport and the NRA should bring forward specific proposals to improve their estimating capabilities for the next national development plan. The Committee would like to be kept informed of the actions taken on this recommendation.**

The Minister fully agrees that Departments and agencies must have in place the necessary systems, controls and skills to effectively manage the implementation of their expenditure programmes; this encompasses all stages from initial appraisal and costing of proposals through to delivery of the final project and post-project evaluation. He would point out that his Department has taken a number of important initiatives in recent years to assist better management of capital programmes and projects. The financial management framework for public authorities engaged in capital investment has been significantly improved through the introduction in Budget 2004 of 5-year rolling multi-annual funding envelopes and new arrangements for the carryover of unspent capital monies at the end of a financial year. The Guidelines for the Appraisal and Management of Capital Expenditure Proposals in the Public Sector and other initiatives taken by the Minister for Finance complement these arrangements.

As regards the structure of public sector contracts, the Department of Finance has developed a suite of new Standard Forms of Contract, which are intended to introduce fixed price lump sum contracts tendered on a competitive basis with optimum risk transfer in line with the Government decision on construction procurement reform. These are currently subject to consultation with the construction industry, and the Minister intends to introduce them soon. Greater cost certainty, value for money and cost effective delivery of projects are at the core of the reforms and they should help authorities to better manage public projects.

In addition to these general developments, the Minister is advised by the Department of Transport that the National Roads Authority (NRA) has also taken a range of measures to strengthen its own cost estimation and cost control arrangements. The measures include:

- greater use of Design and Build contracts which transfer more risk to the contractor and provide greater certainty of outturn cost,
- standardisation of designs for high cost items such as bridges,
- buyout of the Price Variation Clause in contracts,
- the publication of design and construction standards, and
- a strengthening of the Authority's cost estimation function.

The Department of Transport has informed the Minister that the combined effect of these measures has improved the management of the National Roads Programme, and that their beneficial impact is now evident in the implementation of major roads projects throughout the country, including the recently completed projects of Monasterevin, Cashel, Ashford/Rathnew, Dundalk Western, Loughrea and Kilcock-Kinnegad by-passes.

The Minister understands that, as part of its monitoring of the implementation of the National Roads Programme, the Department of Transport is continuing to pursue the further strengthening of the NRA's cost estimation and cost control arrangements. Expert consultants are advising the NRA in this key area and the NRA has also assigned additional resources to further strengthen its capability in this area following approval given in 2005 to the recruitment of additional staff.

Arising from the above response, the Minister has been informed by the Department of Transport that it is confident as to the robustness of the road costings included in the Transport 21 Programme and to be included in the next National Development Plan.

- **The Department of Finance should keep the impact of the move to different contracting arrangements for both contractors and consultants under review and should commission an evaluation of the effect of the new arrangements on the overall costs of major road developments.**

As referred to in the Minister's response to the previous recommendation, his Department has undertaken a range of initiatives to help authorities better manage their capital investment activities and reduce the level and the cost of risk retained by the State in public projects. One such initiative has been the development by the Department of Finance of a suite of new Standard Forms of Contract and Conditions of Engagement for Construction Related Services. These currently are the subject of consultation with the construction industry, and the Minister intends to have them in place soon. The new arrangements will introduce fixed price lump sum contracts tendered on a competitive basis as the norm. The operation of the new contracts and terms of engagement of consultants will be kept under review by the Government Contracts Committee for Construction (GCCC) that is chaired by the Department of Finance.

- **The Department of Transport should develop suitable performance indicators similar to those used in other countries so as to enable the evaluation indicators to take account of all the costs and benefits involved in the Road Programme.**

The Minister understands that the Department of Transport and the NRA monitor implementation of the National Roads Programme by reference to a number of factors, including performance indicators relating to the extent of the road network upgraded, the extent of road network restored annually, journey time savings on major inter-urban routes, and level of service on the national primary and secondary network. The Minister is informed by the Department of Transport that programme monitoring arrangements are being reviewed at present, and that the further development of the indicators, improved reporting arrangements, and international experience will be considered in this context.

- **In the context of the new multi-annual budgeting arrangements, the Department of Transport should increase its ex-ante evaluation activities of the Roads Programme, including active measures to control cost inflation, and consider greater use of the expenditure review initiative to inform its policy formulation in this area.**

The Minister agrees that ex-ante evaluation of all investment programmes is important. He would point out that he has commissioned an ex ante evaluation of investment priorities for the next NDP, which is currently being conducted by the ESRI. He would also point out that the National Roads Programme has been evaluated and reviewed closely in the context of the current National Development Plan (NDP). Relevant evaluations in recent years include the "Evaluation of Investment in the Road Network" by Fitzpatrick Associates (August 2002) and the "Mid-Term Evaluation of the Economic and Social Infrastructure Operational Programme" by Indecon Consultants (September 2003). These confirmed the continuing relevance and appropriateness of the national roads development provided for in the NDP.

In October 2003, the "Mid-term Evaluation of the NDP/CSF" by the Economic and Social Research Institute concluded that the overall strategy underlying the Plan was as valid as when it was first drawn up. It found that the returns to investment in physical infrastructure, especially roads, were very substantial and recommended further concentration of resources on the Plan's investment in national roads.

The Department of Finance's revised "Guidelines for the Appraisal and Management of Capital Expenditure Proposals in the Public Sector" (2005) (see above), put a new specific obligation on Departments to carry out both prior and mid-term evaluation (at the beginning and mid point of each five-year cycle) of all programmes with an annual value in excess of €50 million and of five years or more duration; the National Roads Programme would come within the ambit of this requirement for regular programme-level evaluation. Departments may decide to carry out these evaluations as part of the ongoing policy review and value for money assessments. The Minister would point out that adherence by Departments and agencies to the revised Guidelines, is one of the conditions attaching to the sanction for capital investment that they receive as part of the multi-annual capital envelopes framework.

As regards measures to control cost inflation in projects and programmes, the Minister would refer to his response to the recommendation concerning the need for a better capacity to produce more accurate cost forecasts for the Roads Programme.

- **The NRA should improve its reporting on governance issues in its annual report. The NRA should improve its dissemination of performance information to members of the Oireachtas and appoint a senior manager as a liaison officer for this purpose.**

The Minister understands from the Department of Transport that, at present, the NRA reports extensively on governance issues in its Annual Report, which is laid before the Houses of the Oireachtas, and also that the Authority is meeting its obligations for reporting to its parent Department, in accordance with the provisions of the Department of Finance Code of Practice for the Governance of State Bodies.

The Minister is aware that the NRA appears before Oireachtas Committees when invited and that, on request, it also provides information direct to individual Oireachtas members. The Minister is informed that, in addition to continuing these arrangements, the NRA has appointed a dedicated liaison officer with the Houses of the Oireachtas, which further strengthens its arrangements for the provision of information to members of the Oireachtas.

- **The NRA should take a more proactive approach to financial management by having more people with financial expertise as part of their management team.**

The Minister is advised by the Department of Transport that the NRA already has access to financial expertise on its staff and to advisers and that it has augmented these resources in recent months and has assigned more professionally qualified staff to the financial management function generally.

- **The Committee supports the attempts to spread tolling geographically so that no region is disadvantaged by a high number of tolls. PPP contracts should include a buyout clause, where it is appropriate, to protect the interests of the tax-payer.**

The Minister notes that the question of the spread and range of tolled projects is a policy matter for decision by the Minister for Transport. He is advised by the Department of Transport that the National Roads Authority already aims for an appropriate geographical spread of tolled roads.

In relation to the inclusion of a buy-out clause in PPP projects, the Minister refers the Committee to the general PPP briefing document supplied by his Department to the Committee in March 2004. This noted that, building on experience here and elsewhere, a number of additional safeguards have been incorporated into PPP contracts as the process has evolved. These include, where appropriate, sharing any refinancing benefits arising, generally post-construction, and building in prepayment rights - i.e. a right to buy out some or all of the private debt finance after a specified number of years of operation of the PPP projects.

The Minister is informed by the Department of Transport that, in the case of the National Roads Programme, PPP contracts currently in place allow for the termination of the agreement. Under these contracts the NRA is entitled to terminate the agreement at any time on three months notice to the PPP company. If the NRA terminates the agreement because of a default by the PPP company, then no compensation is payable on termination. If the NRA terminates the PPP agreement for another reason, then the PPP company is compensated as if it had proceeded according to the Contract. In the latter case, the amounts payable by the NRA would comprise all outstanding senior debt and junior debt, sub-contractor losses, and the equity value less specified deductions such as the PPP company's bank account credit balances.

Given under the Official Seal of the Minister for Finance this 20th day of July, 2006

L.S.

David Doyle
Secretary General
Department of Finance