

Review of Highways England's delegated expenditure controls

Prepared by the Highways Monitor for the Department for Transport

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1. Introduction

One of ORR's core activities as the Highways Monitor is to assess Highways England's compliance with the assurance arrangements set out in the company's framework document with the Department for Transport (DfT)¹. These arrangements include the financial controls that Highways England is required to have in place because the company has delegated authority to incur expenditure on behalf of DfT.

This report summarises the findings of our review of Highways England's delegated expenditure controls in May and June 2016.

Our work has been undertaken as per the requirements of the Memorandum of Understanding between ORR and DfT² which requires us to assess Highways England's compliance with the assurance arrangements in sections 7.2 to 7.8 of Highways England's framework document³.

2. Methodology

The scope of our work and detailed testing procedures were developed based on discussions with DfT and Highways England and review of the documents listed below:

- the Memorandum of Understanding between us and DfT;
- the Highways England framework document, in particular sections 7.2-7.8;
- a draft 'delegations checklist' of the controls that should be included in our review that was provided to us by DfT in February 2015;
- assurance and governance papers presented by Highways England to DfT's Board Investment and Commercial Sub-Committee ('BICC') in November 2015 and December 2015; and

¹ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414863/highways-england-framework-document.pdf

² See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/411801/mou-orr.pdf.

³ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414863/highways-england-framework-document.pdf.

- a *Delegations Assurance for Highways England* presentation to BICC by DfT in January 2015.

The scope of our work and detailed testing procedures were agreed with DfT and Highways England prior to commencement of our work.

Our work comprised of a combination of document review and sample testing supported by discussions with Highways England and DfT. We note that DfT's Roads Economics and Modelling team conducted a review of investment appraisal capability at Highways England in November 2015 with a follow up review in May 2016 with a report of their findings presented to DfT's Board Investment and Commercial Committee (BICC) in June 2016. We identified a number of overlaps between DfT's work and our requirements and we have placed reliance on DfT's work in some areas, in particular DfT's review of the establishment of the Chief Analyst's unit. We have worked together to reduce duplication and burden on Highways England across these respective pieces of work.

3. The scope of our review

Our review was structured around the following four criteria which were set out by DfT to Highways England:

A. Culture, credibility and capability

Highways England is publicly credible in its efforts to ensure good value for public money.

B. Control

The Board and Accounting Officer of Highways England are effective, with governance systems that allow it to promote value for public money and ensure that relevant standards are met.

C. Decision-making

The decisions taken in Highways England on its investment are consistent, evidence-based and enhance value for public money.

D. Evidence

The information and analysis which support investment decision-making in the company are robust.

4. Results

The results from our testing are summarised in this section.

A. Culture, credibility and capability

A1. Appointment of a Chief Analyst, responsible for the quality of analysis across Highways England

Stephen Elderkin was appointed Chief Analyst on 2 November 2015. The job specification looks appropriate, based on our understanding of DfT's requirement of this role.

A2. Creation and maintenance of sufficient economic and analytical expertise to quality assure work carried out by individual project teams

Recruitment of economists to the Chief Analyst's Unit has commenced though it is still in progress. Work to assess whether the unit has sufficient economic and analytical expertise was undertaken as part of DfT's May 2016 review, with a report presented to DfT's BICC in June 2016. As agreed with DfT we have not duplicated this work.

A3. Representation of Chief Analyst and expertise on the Investment Decision Committee

Highways England maintains an attendance log for each Investment Decision Committee meeting. The Chief Analyst has attended each meeting following his recruitment through to the end of March 2016.

A4. Regular reporting of information to the DfT shareholder team, client team and Highways Monitor in line with agreed data sharing provisions, including any information which the Principal Accounting Officer requests in order to fulfil their obligations

DfT's shareholder team, client team and ORR receive the same monthly data pack as is provided to Highways England's executive team. In addition, we have published monitoring reporting guidelines in December 2015, which set out information about Highways England's performance that the company is required to publish on an annual basis. Highways England has shared its first draft of these monitoring reporting statements with us and is due to publish them in July 2016.

A5. Cooperation with the work of any client advisor, through the provision of information and responding to recommendations made

DfT has not yet appointed a client advisor as no suitable candidates were found in the first round of procurement. DfT is fully sighted on this issue and is currently reviewing the specification and options to ensure the requirement is still fit for purpose and meets the needs of the stakeholders. From our discussions with DfT and Highways England, our role in the change control process and our regular monitoring activities we are not aware

that the absence of a DfT client advisor may have affected DfT's access to Highways England's investment decisions during 2015-16.

A6. Compliance with the requirements of the call-in regime set out in the framework document

There are four tiers to Highways England's call-in regime. All Tier 1 projects (over £500m or 'novel and contentious') are automatically 'called-in', i.e. must be approved by DfT's BICC before proceeding to the next business case stage. Tier 2 (£200m to £500m) and Tier 3 (£50 to £200m) projects are not automatically called in. In standard cases approval is granted internally by Highways England's Board for Tier 2 projects and the IDC (Investment Decision Committee) for Tier 3 projects. However, Tier 2 and Tier 3 projects can be called in to DfT if they are novel or contentious, or expectations set out in the Road Investment Strategy are no longer valid. Tier 4 projects (under £50m) are approved within Highways England's relevant directorate subject to finance approval.

Tier 1 projects are outside of Highways England's delegated expenditure controls and we have not reviewed approvals of these by DfT. The call-in regime was not used in 2015-16.

Although not initiated through the call-in regime, Highways England has engaged with DfT where there have been changes to scope or timing of projects. Examples include the A50 Uttoxeter and M54/M6 Toll link road. These changes are being processed through the recently established DfT Change Control process.

A7. Establishment or continuation of centres of expertise responsible for supporting and quality assuring work to assess the strategic, financial, economic, commercial and management implications of proposed investments, drawing on relevant central guidance where appropriate

The delegation of expenditure controls to Highways England required the company to set up five Centres of Excellence to ensure sufficient level of challenge for investment decisions. Highways England has set up Subject Matter Advisors (SMAs) which we understand are the equivalent of the Centres of Excellence at DfT. Three of the five areas are fully established (Economic, Procurement and Strategic). Whilst there is a Finance SMA, Highways England acknowledges that this needs to develop. Arrangements for the final Management role are being finalised. The SMAs are required to provide challenge at all stages in the approval of business cases. The IDC End-to-End manual and Draft SMA guidance set out the role of the SMAs at each stage of the business case production and as such provide relevant guidance on these roles.

Our business case testing found evidence of challenge to investment decisions by SMAs. We would note that DfT's May 2016 review of value for money and analytical assurance found that at that time the SMAs had little experience in identifying and tackling value for

money or analytical assurance issues. Given that Highways England is a new company, we would not expect the SMAs to be operating at the same level as DfT's own Centres of Excellence at this time, but this is accordingly an area where progress will need to be monitored by the Board and the Department. DfT's recent review noted that Highways England has made good progress to embed value for money and analytical assurance in decision making. However, the review noted that more development is required for Highways England to replicate DfT's standards across all areas. Highways England has developed a plan to address this.

B. Control

B1. Non-executive director(s) specifically tasked with checking and challenging the work of the Capital Portfolio Management Office⁴ and the Chief Analyst's unit

The Capital Portfolio Management Office (CPO) is still being established and we have not seen evidence that Highway's England has set up a structure for a non-executive director to check and challenge the work of the IPMO. We provide further comment on this in sub-section C2 below.

We also note that to ensure that an appropriate level of check and challenge is being provided over the work of the IDC and the Chief Analyst's Unit, the IDC terms of reference states that a non-executive director must form part of the IDC. Our review of IDC minutes has shown that Simon Murray, a non-executive director, is part of the IDC and that he has provided challenge to investment decisions.

B2. Maintenance of the assurance provided by the Project Control Framework, and its adaptation and extension to investment across the rest of the company

Covered in sub-section B3 below.

B3. An equivalent or equivalents to the Project Control Framework (as currently used in Major Projects) to govern investment across Highways England

Highways England produced a new IDC framework in April 2015 which replaced the previous Investment Control Framework (ICF) process used by the Highways Agency. The IDC framework is supported by business case guidance and business case templates.

The IDC framework manual describes the information requirements, approvals procedures and responsibilities for each stage of the development of a business case. The business case guidance and template are required to be used for investment decisions over £1m. These provide detailed requirements for what each section of the business case should include. This should support consistency in investment decision making.

⁴ Also referred to as the Integrated Portfolio Management Office (IPMO).

We have reviewed implementation of the IDC framework through testing evidence supporting a sample of investment decisions. Ten Tier 2 and Tier 3 projects have been approved by IDC in 2015-16. Of these, we selected a sample of five covering approvals at different stages of the IDC process. This consists of one strategic outline business case, one outline business case, one case at Design Stage (also an outline business case) and two at full business case stage. We selected the three largest cases in terms of expenditure and then a further two at random. Our sample represents 74% of total approved expenditure.

Two business cases within our sample have been developed since commencement of the IDC framework. The other three cases within our sample had already commenced investment approval prior to April 2015, i.e. under the previous ICF with only later stages investment approval being processed under the new IDC framework in 2015-16.

For the two cases produced entirely under the new IDC framework, our review found that approved investment decisions had been made consistent with the requirements of the framework. In both cases, the five components of the 'five case business model' (strategic, economic, financial, commercial and management) had been completed consistent with the IDC framework. However, we note that the strategic and economic cases were more comprehensive than the financial, commercial and management cases. In our discussions with Highways England, the company has been open about this matter and its intention to strengthen these.

The business case guidance includes a checklist of topics to be completed before and after submission of the business case for approvals to the required investment decision maker⁵. Our review found that this is often not formally completed. Although completion of the checklist does not appear to be currently mandated, completion of the checklist would provide a further layer of assurance that all required elements have been fulfilled. We therefore suggest that Highways England should consider mandating completion of the checklist as part of the business case guidance.

When providing updates to the IDC on business cases, the SMA reports to IDC that we reviewed often included the entire business case, in addition to the review of the case conducted by the SMA. We suggest that the efficiency and effectiveness of SMAs' communication with the IDC could be improved by including a more summarised version of the business case and its key points in their updates to the IDC.

As part of our appraisal of the IDC processes, we looked at the review process. The Independent Assurance Review (formerly OGC Gateway Review) process is undertaken by the Cabinet Office for medium to high-risk projects or internal review team members for low risk projects. These reviews are conducted at key stages of the programme. The

⁵ For example, whether all sections of the business case have been completed.

reviews are mandatory at each stage and highlight key issues to senior management relating to schemes. We identified no issues in our review of this process.

We have seen evidence of lessons learnt exercises being conducted at each stage of the IDC process. At the final stage a lessons learnt report is produced with a list of recommendations. These are then stored in Highways England's document management system that all staff have access to.

C. Decision-making

C1. Establish an Investment Control Framework, with appropriate mechanisms for approving investment

Highways England has established a documented investment control framework (the IDC framework) with clear mechanisms for approving investment decisions.

C2. Establish a capital portfolio management office (CPO), able to support consistent investment decisions across the company

To support effective decision making, Highways England was required to establish a capital portfolio management office. Highways England has established a CPO team that attends the IDC and Highways England Board, as appropriate. However, a fully resourced CPO with a clear remit is currently being established. We requested information about the development of the CPO, including, for example, its terms of reference. However, we have not received information about plans for the future functioning of the office, as none were yet available, although we recognise that Highways England are working towards establishing relevant documentation. We note that capability in this area is being supported through resource provided from the Programme Delivery Partner Framework (supplied by CH2M Hill).

C3. Continued use of the Treasury's five-case model for appraising investment

The HM Treasury five-case model for investment appraisal is incorporated in the IDC framework, associated business case guidance (and templates) and the SMA guidance document (which is currently in draft). Our review has found that the work of the SMAs has been undertaken consistent with the draft SMA guidance though we would suggest that Highways England should look to finalise this guidance. We understand that Highways England is intending to do this and is currently working towards finalising this. As explained in Section B, our business case testing found that the strategic and economic cases were more comprehensive than the financial, commercial and management cases. As noted above, Highways England has stated that it intends to strengthen the financial, commercial and management cases supporting investment decisions. We consider that the SMAs should be adequately resourced with trained staff of sufficient seniority, expertise and independence to be able to provide robust and independent challenge to project delivery teams.

D. Evidence

D1. Publication of full business cases for major schemes worth £50m or more following investment decisions

Included within sub-section D2 below.

D2. Publication of statements of prioritisation for larger programmes of spending (whose elements are not covered by the publication of full business cases)

Statements of prioritisation relate to expenditure on designated funds only where Highways England has stated that more work needs to be completed in terms of testing and feasibility before progressing to statements of prioritisation. Highways England has not yet published any statements of prioritisation or business cases more generally.

From our enquiries we understand that the requirement for Highways England to publish statements of prioritisation for larger programmes of spending whose elements are not covered by the publication of full business cases was agreed with DfT as part of the delegation and assurance framework and with HM Treasury as part of Highways England providing greater transparency on investments to the public for scrutiny. However, we also understand that this requirement was not formally mandated.

Highways England has informed us that it is considering the most appropriate way to publish business cases and statements of prioritisation, taking various factors into consideration including commercial confidentiality. Highways England has mentioned that it is considering whether updates to the Delivery Plan may be the most appropriate way to meet this obligation. We consider that providing transparency about investment decisions is important to Highways England's stakeholders, and we would suggest that DfT considers Highways England's suggested approach will satisfy the department's expectation for greater transparency.

D3. Publication of post-opening project evaluations (POPEs) and associated analysis

POPEs are produced one year and five years after a scheme opens. No POPEs have been produced for new RIS projects, however, Highways England as continued to publish POPEs for projects that commenced before the start of the road period. We reviewed the process for producing POPEs and note that recent examples have shown that there can be considerable time lags between the production and publication of a POPE. We suggest that there may be scope for improvement in the timeliness of publication.

D4. Support to the monitor in carrying out its duties

We can confirm that Highways England has supported our activities, including the production of our half year report and full year annual assessment.

D5. Six-monthly reviews of the development of Highways England's chief analyst's unit with the Department's analysts

DfT's Roads Economics and Modelling team conducted reviews in November 2015 and May 2016.

D6. Support for a transitional review of assurance practice in 2017, and any steps that it may recommend

We understand that DfT is still planning to conduct a review of Highways England's expenditure controls and their functioning. We are not aware of any reason to doubt that Highways England will support this review.

Summary

Overall, Highways England's procedures for investment decisions appear to be clearly documented and appear to be adhered to. We note the following:

- a. A Chief Analyst has been appointed though resourcing his team has been slow and is ongoing. DfT is aware of this;
- b. Subject Matter Advisors (SMAs) have been established to provide challenge in the approval of business cases. Our review has found that the work of the SMAs has been undertaken consistent with draft SMA guidance though we suggest that Highways England should look to finalise this guidance. We understand that Highways England are intending to do this;
- c. Our sample testing of business cases found that the strategic and economic cases were more comprehensive than the financial, procurement and management cases of Highways England's five case business model. Highways England has stated that it intends to strengthen the financial, commercial and management cases supporting investment decisions;
- d. The business case guidance includes a check list of topics to be completed before and after submission of the business case for approvals to the required investment decision maker. This is not currently mandated and our review found that this is often not completed. We suggest that mandating completion of the checklist would provide a further layer of assurance that all required elements have been fulfilled; We also suggest that SMAs' communication with the IDC could be improved by including more summarised versions of the business cases in their updates to the IDC.
- e. Highways England agreed with DfT to establish a capital portfolio management office (CPO). A fully resourced CPO with a clear remit has not yet been established and we have not been able to obtain information about the development of the CPO, including, for example, its terms of reference or plans for the future functioning of the office. We note that Highways England are working towards setting up this body and that capability in this area is being supported by a project delivery partner (CH2M Hill);

- f. There appear to be opportunities to improve efficiency by reducing duplication of information across different materials supporting investment decisions;
- g. Post-opening project evaluations (POPEs) are required to be produced one year and five years after a scheme opens. Our review identified that there may be scope for improvement in the timeliness of publication of these; and
- h. Highways England agreed with DfT (and HMT) to publish business cases and statements of prioritisation for larger programmes of spending to provide greater transparency on investments to the public for scrutiny, though this requirement appears to have not been formally mandated. Highways England has informed us that it is still considering the most appropriate way to publish these (taking various factors into consideration including commercial confidentiality).