PUBLIC ACCOUNTS COMMITTEE
THE STATES OF GUERNSEY

A COST / BENEFIT REVIEW OF THE FINANCIAL TRANSFORMATION PROGRAMME

COVERING REPORT

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Content

Chair's Statement

The Financial Transformation Programme (FTP) has undeniably had a major impact on the States of Guernsey over the 5 years of its existence. Its sheer scale, benefits claimed and importance placed on it to bring a fundamental change to the culture of fiscal discipline, has meant that the Public Accounts Committee (PAC) has taken an active interest throughout.

The PAC had wanted to investigate the FTP for some time and, back in February 2014, I asked the Treasury & Resources Minister[1], on behalf of the PAC, to agree to an independent review of the benefits claimed. This was acknowledged, though it was requested not to intervene while the FTP was in full flow due to the impact it could have on resources. Bearing this in mind, the PAC delayed undertaking a substantive review until the autumn of that year.

The PAC was conscious of the size and complexity of the FTP and the potential for a single review to be too broad and far-reaching to complete with the time and resources available to it. It was therefore decided to take a staged approach, focusing initially on the financial costs and benefits of a sample of major projects. Further reviews, encouraged by the PAC, are planned to cover areas such as change management, programme & project governance and cultural transformation.

This review, undertaken in partnership with KPMG, provides an independent financial test of 9 major projects (representing 35% of the total approved savings) in terms of benefits, costs to achieve them and their likely sustainability.

It is pleasing that KPMG found that budgets were largely validated, with examples of good practice identified. It is also good to know that the Consultant was correctly remunerated as per the contract. However, there are a number of key findings which raise questions over various aspects of claimed savings. These include:

- a lack of documented financial rules from the start of the programme;
- advantage not being taken of a beneficial clause in the contract by the States of Guernsey;
- a lack of consideration of the effect of savings on other Departments and States' owned entities; and
- the issue of approval of savings that have yet to be made.

Furthermore, the PAC is concerned as to whether a reduction to a budget should automatically constitute a real cash saving.

Whilst significant savings have undoubtedly been made, it is not clear in some instances whether these will be sustainable. It is already evident that savings used as the basis to determine the Consultants' fees have had to be revised. KPMG make it clear that ongoing monitoring is vital to ensure that benefits are sustained, and that planned future savings are actually made.

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[1] *as political champion of the FTP*

More generally, looking at Appendix 5 and 6 of the KPMG report, the change of governance half way through the FTP was considerable. Whilst not at the core of this particular review, this change undoubtedly had an effect on the approach taken by Departments. The consequence would appear to be a focus on savings of a more tactical nature, to meet annual reporting targets, rather than on those reflecting the original genuine transformation agenda of the FTP.

The FTP has come at a significant cost, both in terms of consultants' fees, maintenance of the States' own share of the joint Programme Management Office and the unquantifiable cost of the Departmental resources involved. It is therefore too early to tell whether this investment has represented value for money.

Furthermore, it is evident and indeed acknowledged, that the job is far from over. As such, the findings from this review, and the other forthcoming reviews into the FTP, must be wholly embraced and embedded within any future change programme if there is to be a real and sustainable transformation of the States of Guernsey.

Deputy H.J.R. Soulsby
Chair, Public Accounts Committee

1. Executive Summary

1.1. The purpose of the PAC's Review was to consider a Cost/Benefit exercise on the major claimed savings within the FTP, incorporating an analysis of the resultant remuneration to the Consultant[2] (2.1). The scope of the Review was tightly focused by the PAC, being conscious of other forthcoming reports into the FTP and the time and resources available to it (2.2).

1.2. KPMG were engaged to perform a financial review of a selection of FTP projects, including an analysis of each project's financial data, verification that the approved savings had been calculated in line with the financial rules and that the Consultant had been remunerated in line with the contracted terms (2.4). KPMG also performed a review of the FSR fund to provide a readily understandable schedule summarising the financial entries (2.5).

1.3. The work of KPMG confirmed that the financial rules were not clearly documented at the beginning of the FTP (3.2). KPMG state that a consequence of the lack of financial rules, '*… has led to uncertainty and debate as to whether certain savings and related Consultant reward fees can be approved*' (3.5) and provide illustrations within their report of such uncertainties (3.6).

1.4. As such, the PAC believes that it may be potentially advantageous for future Programmes of this complexity to consider specialist input when the contract and/or related documents (i.e. Programme Management Strategies) are being drafted and that it would be worthwhile reviewing the approach to drafting such documentation of this type in the future (3.9).

1.5. KPMG identified that a total of £5.14m was paid to the Consultant throughout the duration of the 5 year contract (4.4). The PAC notes with interest the breakdown of costs for the Consultant and specifically that the reward fee makes up only approximately 1/3 of the overall remuneration. With regard to the reward fee element, the PAC acknowledges KPMG's finding that there was no significant difference based on the contract provisions (4.9).

1.6. The PAC acknowledges the examples of good practice identified within the report and notes the significant contribution to the General Revenue of many of these Projects (5.23). However, there are a number of issues highlighted within the report that raise concerns with the PAC, specifically whether:

- an advantageous clause in the contract should have been evoked by the Policy Council;
- future savings should have been approved;
- costs charged through non-General Revenue accounts or States owned entities should have been considered to be internal transfers (5.24); and
- budget reductions should have been considered as a 'real' cash saving (3.4).

1.7. Furthermore, the PAC is concerned by KPMG's summation that ongoing monitoring of the benefits would be vital to ensure the sustainability of the benefits (5.25).

1.8. Inevitably for any programme of this scale, there are a number of lessons that must be learnt. The KPMG report establishes from this sample of projects that there were examples of good practice, together with areas of concern and, as such, justifies the need to maximise the learning process through this and other forthcoming reviews into the FTP (6.11).

[2] *The scope of work for the Review can be seen within Appendix 1 of the KPMG Report.*

2. Approach to the Review

2.1. The purpose of the PAC's Review was to consider a Cost/Benefit exercise on the major claimed savings within the FTP, incorporating an analysis of the resultant remuneration to the Consultant[3].

2.2. The scope of the Review was tightly focused by the PAC, being conscious of other forthcoming reports into the FTP and the time and resources available to it. Areas that were not included within the scope of the review included an assessment of the quality of the outputs from the projects, non-financial benefits of individual projects and the change management methodology of the Programme[4].

2.3. Following consideration of various options, the PAC decided to commission a suitably qualified external agency to work in partnership in undertaking this Review.

2.4. KPMG were engaged to perform a financial review of a selection of FTP projects[5], including an analysis of each project's financial data, verification that the approved savings had been calculated in line with the financial rules and that the Consultant had been remunerated in line with the contracted terms.

2.5. KPMG also performed a review of the FSR fund to provide a readily understandable schedule summarising the financial entries.

2.6. The selected projects contributed £10.1m (approximately 35%) to the final approved savings total of £28.7m and consisted of savings in respect of:

- The Guernsey Registry;
- College Subsidy;
- Air Subsidy;
- Higher Education Parental Contribution;
- SAP/STSC;
- Voluntary Severance;
- Vacancy Factor;
- Visiting Consultants; and
- Claims Management.

2.7. The work performed was limited to key documentation, including relevant States Reports, statements from the PAC, the States of Guernsey Accounts, the Contract, Novation Agreement and Partnership Agreement with the Consultant, together with the individual projects' business cases and related records. In support of this task, KPMG held interviews with key members of the FTP and project teams to gain an understanding of the FTP process and the specific projects.

2.8. The draft report was distributed to key contributors to establish the factual accuracy of the findings within the report.

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[3] *The Terms of Reference for the Review can be seen within Appendix 1.*
[4] *Full details can be seen within the full Terms of Reference*
[5] *The PAC selected the FTP projects against an agreed criterion as detailed with the Terms of Reference*

3. The Contract, Financial Rules & Benefits Management

3.1. As part of the initial investigatory work undertaken by the PAC, the original Tribal Contract and the Deed of Novation were reviewed. This revealed areas that required further clarification. In particular, the PAC was concerned that the original contract may not have set out the financial rules required to manage the contract on an ongoing basis.

3.2. The work of KPMG confirmed that the financial rules were not clearly documented at the beginning of the programme, '*The Contract does not clearly specify what constitutes a saving, or whether any associated costs are able to be offset, in calculating the savings banked by SOG (The States of Guernsey), upon which the consultant's reward fee is calculated*.' (KPMG p10).

3.3. It is noted that guidance on what constituted a saving was not given until the Chief Minister's response to a Rule 6 question in August 2014.

3.4. The PAC also notes, with interest, '*Rule 3'* from this statement that states, '*It (the saving) must be calculated net of any associated costs*' (KPMG p17) and the further affirmation that internal transfers would <u>not</u> be eligible for consideration within the FTP. In addition, an area of concern for the PAC is the assumption from '*Rule 1'* that a reduction in budget constitutes a '*real'* saving to the taxpayer; the Vacancy Factor being a potential example.

3.5. KPMG continue, stating that a consequence of the lack of financial rules, '… *has led to uncertainty and debate as to whether certain savings and related Consultant reward fees can be approved*.' (KPMG p10).

3.6. KPMG provide illustrations within their report of such uncertainties; which are further considered within Section 4. However, by way of example, whether savings scheduled to be made in the future could be approved was open to interpretation, as was what constituted an internal transfer; an area of specific concern previously highlighted by the PAC.

3.7. The process that unfolded to decide whether a saving was legitimate could have been avoided if the rules (and their interpretation) had been clearly drafted, and more widely communicated, at an early stage of the programme.

3.8. KPMG also highlighted that there has been insufficient ongoing monitoring of benefit management following the sign-off of approved savings. (KPMG p11, 19, 25 & 29). This is of concern to the PAC, especially now the Programme is closed, and may have implications regarding the sustainability of certain savings as identified within the report. Again this could have been avoided if the strategy for the management of benefits, specifically how and by whom the benefits were to be monitored, had been clearly drafted and communicated.

3.9. **In conclusion, the finding by KPMG that the financial rules were not clearly documented at the early stage of the Programme is of serious concern to the PAC. The PAC believes that it may be potentially advantageous for future Programmes of this complexity to consider specialist input when the contract and/or related documents (i.e. Programme Management Strategies) are being drafted and that it would be worthwhile reviewing the approach to drafting such documentation of this type in the future.**

4. The Fundamental Spending Review (FSR) fund and Remuneration

4.1. The KPMG report shows that the FSR Fund generated a surplus of £16.05m up to 31 December 2013. Cumulative transfers, at that point in time of £23.18m, had been made to the General Revenue Reserve which has effectively repaid the initial £10m capital injection as well as making £13.18m available for SSP projects and reducing the deficit. (KPMG p14)

4.2. However, KPMG identified a concern that one-off project costs were not all accounted for through the FSR fund but rather through the General Revenue or applicable capital accounts. The identified one-off costs within the sample of projects included £2.53m of Voluntary Severance payments and £0.84m for the SAP project. (KPMG p12 & 14).

4.3. As indicated by KPMG, the PAC is conscious that time spent delivering projects by States of Guernsey employees, outside of the Programme Management Office (PMO)[6], was not monitored (KPMG p14). As such, the internal cost of this resource was not identified nor potentially reflected within the FSR accounts.

4.4. In terms of the Consultant's remuneration, KPMG identified that a total of £5.14m was paid to the Consultant throughout the duration of the 5 year contract (KPMG p15) as detailed below:

Remuneration to the Consultant	£,000
Reward Fee	1,813
PMO Fee	1,852
Executive support	263
Expenses	913
Other days & related expenses	295
Total	**5,136**

4.5. KPMG performed a recalculation of the £1.81m reward fee and, based on the contract provision, have not noted any significant differences (KPMG p15).

4.6. The Review identified that the Consultant's fee of £1.85m for its role within the PMO was 264k (c17%) higher than provisioned in the contract. Most of these extra costs occurred in years 2 and 3. However, KPMG do affirm that the contract allowed for additional PMO fees should the States of Guernsey be unable to provide the necessary resource to cover its contractual obligation (KPMG p15).

4.7. Balanced with this, the PAC acknowledges the comment within the report that expenses were markedly under the potential amount allowed by the contract.

4.8. The Consultant's contract expired on 31 October 2014 and no fees were payable in relation to the FTP project subsequent to that date. The FTP concluded on 31 December 2014, having total approved savings of £28.68m per annum.

4.9. **In conclusion, the PAC notes with interest the breakdown of costs for the Consultant and specifically that the reward fee makes up only approx. 1/3 of the overall remuneration. With regard to the reward fee element, the PAC acknowledges KPMG's finding that there was no significant difference based on the contract provisions.**

[6] *a joint venture between the supplier and the government*

5. The Review Projects

This section represents a summary only and must be read in conjunction with the full KPMG report

Air Subsidy (KPMG p18 & 19)

5.1. Whilst this project delivered a significant approved saving of £731k, it also demonstrated the potential adverse consequences on other Departments of implementing a project if the holistic effects are not adequately considered when calculating approved savings.

5.2. Of further concern to the PAC is the specific inclusion of an approximate £365K cut in subsidy to Aurigny. KPMG highlight that, unless Aurigny have taken specific action to transfer these costs to the users of the airline, then the cut would impact on their '*bottom-line'*. This, in turn, will directly affect the States of Guernsey accounts. As KPMG state, *'(States of Guernsey) may be required to provide additional support to the airline which is historically loss-making'*.

5.3. As a wholly owned trading entity of the States of Guernsey, this cut in subsidy could be potentially considered to be a further internal transfer of costs.

Claims Management (KPMG p20 & 21)

5.4. The KPMG Review identifies that the approved savings through this project of £565k was almost triple the originally anticipated £189k.

5.5. SSD, in partnership with the Consultant, appear to have remodelled the process into a more efficient method, not only saving significant money but increasing its proficiency. The PAC considers that this project represents an example of good practice where savings were achieved through a transformation of a process.

SAP/STSC (KPMG p22 & 23)

5.6. The KPMG report presents a number of observations with regard to this individual project.

5.7. As identified by KPMG, a clause in the contract was not evoked, which would have enabled the cost of capital to have been taken into account when determining the approved savings. Given that the capital investment of the SAP/STSC totalled £7.9m, this would have had a significant effect on the quantum of approved savings.

5.8. The PAC also has concerns with regard to the various downward adjustments to the approved savings; from an anticipated £1.7m to, at the time of the Review, £673k. The PAC notes the Consultant's comment that the final adjustment was made *'to show prudence'* and that, '*at the point the contract ended …. the SAP Project Team expect the savings to be re-established either in 2015 or 2016'.* This was considered justification for payment being based on a higher figure than the £673k approved saving. KPMG note that no request for a refund was ever forthcoming from Policy Council.

5.9. As a consequence of the above, the appropriateness of the claimed savings of this particular project is a matter of concern to the PAC.

Higher Education Parental Contribution (KPMG p24 & 25)

5.10. Savings made on Higher Education Parental Contributions stood, at the time of the Review, at £217k, with a further £695k expected to be realised on an incremental basis in the future. The approved saving was £912k.

5.11. Whilst the adjustments to the Education Department's budget will be made in due course, there is uncertainty as to whether the actual savings will be achieved. KPMG state, '*No evidence has been noted of ongoing monitoring of actual versus expected savings*'. As such, a clear and robust process to monitoring these savings on an ongoing basis is vital.

5.12. Although significant savings are yet to materialise in cash terms, KPMG note that a decision was made by Policy Council for the Consultant to be paid based on the full entitlement.

Voluntary Severance (KPMG p26 & 27)

5.13. The PAC reports a significant reduction of £1.5m in the ongoing General Revenue costs due to this project. Further savings were made as part of a Strategic Talent Programme but this was not within scope of the FTP.

5.14. The PAC was reassured, to some degree, that KPMG identified controls have been put in place, specifically at an individual level, to ensure that the benefits of this project are maintained. However, PAC believes that, once again, ongoing monitoring is vital to ensure the sustainability of this project's benefits.

5.15. It is with interest that the PAC notes KPMG's comment that the approved savings as a result of this exercise did not taken into account reduced expenditure on Pension or Social Security contributions, both of which may have resulted in a reduction in net revenue expenditure.

Guernsey Registry (KPMG p28 & 29)

5.16. From the information provided within the report, the PAC acknowledges the significant increase in income of £2.3m from this project. This considerably exceeded expectations and represents nearly 8% of the overall FTP benefits.

5.17. However, the PAC notes with interest that the original legislative change to enable this project occurred some years prior to the FTP and that it was, as KPMG identify, '*an interpretation in the actual wording of the law……..'* that limited the income generation to the States of Guernsey until the implementation of this project.

College Grants (KPMG p30 & 31)

5.18. The PAC acknowledges the reduction of costs of £1.2m, though it notes that the savings will not take full effect until September 2018. As with the Parental Contribution project, this highlights the importance of ongoing monitoring of actual savings.

Visiting Consultants (KPMG p32 & 33)

5.19. The PAC were reassured by KPMG's finding that the rationale for the transfer remains robust and may even have generated savings not identified within the FTP process.

5.20. However, the KPMG report states that '*the transfer in itself does not lead to a £650,000 saving to public expenditure as a whole'* and, whilst respecting Policy Council's differing interpretations, the PAC believes its continued inclusion is questionable. The PAC also wishes to bring attention to the finding within the report that the Consultant refunded the States of Guernsey £42,250, being the element of the reward fee for this specific project.

Vacancy Factor (KPMG p34 & 35)

5.21. The PAC acknowledges KPMG's view that this project represents an example of '*accepted commercial practice'* with a significant approved saving of £1.6m.

5.22. However, this project represents an example of a 'budgetary' saving rather than actual 'cash' saving. KPMG state, '*The actual savings generated by this Project relate to the portion of the miscellaneous expenditure through the staffing budget*.' They go on to state that, '*The key benefit achieved ….. is a change in the budgeting culture ….*'

General

5.23. **In conclusion, the PAC acknowledges the examples of good practice identified within the report and notes the significant contribution to the General Revenue of many of these Projects.**

5.24. **However, there are a number of issues highlighted within the report that raise concerns with the PAC, specifically whether:**

- **an advantageous clause in the contract should have been evoked by the States of Guernsey;**
- **future savings should have been approved; and**
- **costs charged through non-General Revenue accounts or States owned entities should have been considered to be internal transfers.**

5.25. **Furthermore, the PAC is concerned by KPMG's summation of more than one project that ongoing monitoring of the benefits would be vital to ensure the sustainability of the benefits.**

6. Conclusions & Next Steps

Conclusions

6.1. It should be clearly stated that it is the understanding of the PAC that KPMG have not identified any fundamental issues which may have affected fees paid to the Consultant on the basis of the provisions within the Contract. The PAC notes with interest the breakdown of costs for the Consultant and specifically that the reward fee makes up only approximately one third of the overall remuneration. (4.9).

6.2. With regard to the reward fee element, the PAC notes KPMG's finding that there was no significant difference based on the contract provisions (4.9).

6.3. However, KPMG have identified that the Contract did not clearly specify what constituted a saving, or whether any associated costs were able to be offset, in calculating the savings banked by the States of Guernsey and upon which the Consultant's reward fee was calculated. The finding by KPMG that the financial rules were not clearly documented at the early stage of the FTP is of serious concern to the PAC (3.9).

6.4. The lack of defined financial rules at the outset of the FTP led to uncertainty (3.5) and debate as to whether certain savings and related Consultant reward fees could be approved.

6.5. The PAC believes that it may be potentially advantageous for future programmes of this complexity to consider specialist input when the contract and/or related documents (i.e. Programme Management Strategies) are being drafted and that it would be worthwhile reviewing the approach to drafting such documentation of this type in the future (3.9).

6.6. With regard to the sample of individual projects, the report did outline some outstanding successes within the FTP. In particular, the Claims Management project introduced a genuinely transformational change within SSD. The PAC acknowledges the examples of good practice identified within the Report and notes the significant contribution to the General Revenue of many of these Projects. (5.23).

6.7. However, there are a number of issues highlighted within the report that raise concerns with the PAC, specifically whether:

- an advantageous clause in the contract should have been evoked by the States of Guernsey;
- future savings should have been approved;
- costs charged through non-General Revenue accounts or States owned entities should have been considered to be internal transfers (5.24).; and
- budget reductions should have been considered as 'real' cash savings (3.4).

6.8. Furthermore, the PAC is concerned by KPMG's summation of more than one project that ongoing monitoring of the benefits would be vital to ensure the sustainability of the benefits (5.25).

Next Steps

6.9. The PAC was conscious that, when drafting the Terms of Reference, other reviews were due to be undertaken including an internal 'Closure Report' which would be presented within a States Billet as the final annual report for the FTP.

6.10. The PAC also anticipated that the FTP as a whole, together with significant individual projects (i.e. SAP), would be subject to a post-implementation review (or programme equivalent); this being established practice within the States of Guernsey.

6.11. Inevitably, for any programme of this scale, there are a number of lessons that must be learnt. The KPMG report establishes from this sample of projects that there were examples of good practice, together with areas of concern. Consequently, there is a need to maximise the learning process through this and other forthcoming reviews into the FTP.