4. Financial framework and control

Summary of contents

4..1. This chapter reviews the statutory framework (paragraphs 4.2 to 4.7), funding and control by the DoE (paragraphs 4.8 to 4.13) and BWB's performance over the period since the 1987 MMC report (paragraphs 4.14 to 4.18). It goes on to outline the financial and accounting structure and systems and the financial planning and budgeting process (paragraphs 4.19 to 4.26). It then discusses property sales and capital expenditure and control of working capital (paragraphs 4.27 to 4.39). A review of BWB's cost analysis and reporting and funding other than Government Grants is set out in paragraphs 4.40 to 4.55. Audit and performance indicators are reviewed in paragraphs 4.56 to 4.63. The chapter is completed with conclusions and recommendations (paragraphs 4.64 to 4.77).

The statutory framework

4..2. The 1962 Act established the commencing capital debt of BWB together with its borrowing powers and set out the power of the Minister to make grants to cover deficits on BWB's revenue account for the five years from vesting date. The 1968 Act made some changes to the commencing capital debt and permitted the Minister to continue to make grants to cover deficits on BWB's revenue account. The Act also laid on the Board the duty to secure `that the best possible financial return is obtained from any asset of the Board which is not an inland waterway or harbour and is not required in connection with the provision of services and facilities by the Board whether by exploiting it, by developing it, or by disposing of it'.

4..3. Under the 1968 Act BWB is required to secure that `its revenues are not less than sufficient to meet its charges properly chargeable to revenue account taking one year with another'.

4..4. BWB has a general power to borrow, with a limit of £30 million, to meet specific requirements. The more significant of these are:

(a) capital expenditure;

(b) working capital;

(c) acquisition of part or whole of an undertaking;

(d) lending money (under specified circumstances);

(e) for subscribing for or acquiring securities of a body corporate otherwise than by way of investment; and

(f) to pay off commencing capital debt or monies borrowed by the Board.

4..5. BWB is required to prepare an annual statement of accounts in such form and containing such particulars that the Secretary of State for the Environment may, with the approval of the Treasury, from time to time direct. The Direction closely follows standard accounting practice and the disclosure requirements of the Companies Acts and the Stock Exchange and best commercial accounting practice, including requirements of the Statements of Standard Accounting Practice. The Board is also required to disclose turnover, operating income and operating costs analysed between its major activities. It is also required to report on its performance against the target established by the 1968 Act-the break-even on revenue account-and against its external financing limit (EFL).

4..6. Under the Direction BWB is required to provide a statement reflecting the effect of changing prices in the form of current cost accounting information.

4..7. In addition to complying with the relevant statutory provisions and with any directions which the Secretary of State may give, the financial relationship between the DoE and BWB is laid down in a Financial Memorandum dated March 1990. The principal features of the Memorandum include the provision of Corporate Plans, Public Expenditure Survey (PES) information and reporting and supply of information to the DoE.

Funding and control by the DoE

External financing limit and Grant

4..8. The following timetable sets out the general procedures leading to the determination of the EFL and Grant:

(a) March-BWB submits its Corporate Plan and IFR bid containing a proposed budget for the following year and plans for subsequent three years;

(b) PES discussions between the DoE and the Treasury;

(c) autumn statement sets EFL (Grant and borrowing) for the following year and planning baselines for further two years; BWB is notified in November;

(d) January-settlement of capital investment ceiling for following year notified to BWB together with planning figures for commitments for further two years (customarily 85 per cent and 70 per cent of proposed investment); and

(e) January-BWB translates settlement figures into budget for following year beginning 1 April and incorporates the budget into its next Corporate Plan (submitted March/April).

4..9. The Corporate Plan which is the basis on which the EFL/Grant and fixed assets expenditure limit are determined provides information on income and operating expenditure and the capital expenditure programme. The IFR summarizes total capital including working capital requirements, the internal resources forecast to be generated and the external finance required. In reviewing the level of resources required by BWB the DoE told us that it attaches as much importance to the trends over a number of years as to the movements in any one year. The objective is to ensure that the appropriate minimum level of resources is achieved.

4..10. The Grant covers net revenue costs. It also includes an allocation to cover expenditure on plant and equipment on which the Treasury return on investment criteria cannot be met. The principle behind this element of the funding is that the related capital expenditure cannot be expected to generate income or cost savings sufficient to service any other form of funding (say through the National Loans Fund (NLF)). The capital element is shown by BWB both in its Corporate Plan and the IFR. Table 4.1 shows the make-up of the Grant showing the split between revenue and capital.

TABLE 4.1 **BWB: make-up of the Grant**

£'000

	1988/89	*1989/90*	*1990/91*	*1991/92*	*1992/93*
Grant for year as notified by DoE	45,800	48,200	49,300	48,700*	51,095
Grant shown in notes in accounts as `entitlement' in year	45,800	48,115	49,291	51,100	51,114
Portion of Grant allocated to capital	1,600	1,038	1,300	1,050	905
Revenue portion of Grant*	44,200	47,077	47,991	50,050	50,209
Grant received in year set against expenditure in previous year by BWB	-6,072	-5,619†	-3,369	-3,977	-3,850
Grant for next year set off by BWB for expenditure in current year	5,700	3,369	3,977	3,850	3,500
Revenue Grant taken up in accounts in year	43,828	44,827	48,599	49,923	49,859

Source: MMC from BWB's annual report and accounts.

*Additional £2.4 million of grant made available in January 1992.
†Small differences from previous years arising from changes in accounting basis.

Payment and control of grant by the DoE

4..11. In each of the five years to 31 March 1993 the whole of the Grant has been taken up by BWB. Grant instalments are payable on the first of each month against estimated net operating expenditure for that month. However, unpaid creditors always exist, particularly at the end of any financial year. This highlights the perennial problem of reconciling normal commercial accounting practice with Government accounting procedures. BWB has gone some way towards meeting the problem, with the agreement of the DoE, by setting up the DoE as a debtor at the year end for an amount equal to the first Grant instalment of the new year, claimed on 1 April. It is assumed that this instalment represents net creditors outstanding from the previous year, although this is unlikely to be the case. Under certain circumstances, possibly somewhat extreme, this could lead to funding difficulties. For example, if a significant amount of work planned, required and begun in one year is not, say for reasons of weather, sufficiently progressed making expenditure planned for one year fall into the following year, then that following year's programme becomes underfunded. Table 4.1 shows the adjustments made to the Grant paid in the year to determine the portion of the Grant allocated by BWB in the profit and loss account for the year.

4..12. The assumption that the first instalment of Grant for the new year which is claimed on 1 April represents net creditors arising from the previous year gives rise to another difficulty. The Grant reflects the operating budget for each year and represents the difference between budgeted expenditure and budgeted income for the year. Thus, whilst the Grant is fixed to cover net expenditure in one year, the Grant paid in one year is accounted for as straddling expenditures in two years. There is, therefore, no direct relationship between the actual out-turn for any one year and the Grant paid in that year. The DoE told us that, mindful of the long-standing problem of reconciling Government and commercial accounting practices, it is currently in discussion with the external auditors to identify possible improvements in the procedures.

4..13. The DoE monitors budget against actual income and expenditure through the year. BWB is permitted, under the IBS arrangements, to use any income it achieves in excess of budget to cover additional expenditure on meeting its statutory obligations-for example, bringing forward spend on urgent repairs.

Financial history

Operating results

4..14. BWB's operating performance over the six years ending 31 March 1988 to 31 March 1993 is summarized in Table 4.2.

TABLE 4.2 **BWB: performance for six years 1987/88 to 1992/93 at out-turn prices**

£'000

	1987/88	*1988/89*	*1989/90*	*1990/91*	*1991/92*	*1992/93*
Income other than Grant	20,622	20,817	24,142	27,129	28,819	33,904
Sale of rights over operational property	-	-	-	625	718	826
Lease premiums	458	75	909	354	471	692
Total income	21,080	20,892	25,051	28,108	30,008	35,422
Expenditure						
Contract works, arrears of maintenance and other engineering	42,367	43,076	47,572	55,287	55,420	59,118*
Other operating costs	18,918	18,000	18,310	19,239	21,079	23,748
Total operating costs	61,285	61,076	65,882	74,526	76,499	82,866
Net interest payable and other costs	2,391	3,063	2,965	-766	-378	-778
Redundancy and severance	547	530	858	2,758	3,720	3,089
Total costs	64,223	64,669	69,705	76,518	79,841	85,177
Revenue grant taken up in accounts in year	43,177	43,828	44,827	48,599	49,923	49,859
Surplus in year†	34	51	173	189	90	104

Source: MMC from BWB Report and Accounts.

*The amount of £59,118,000 is estimated on previous years' engineering costs as a percentage of total operating costs.
†This is the revenue profit in year retained, ie (total expenditure minus total income other than Grant) less Grant.

Over the six years income other than Grant has risen, at out-turn prices, by just over £13 million or 64 per cent. Property income accounts for £8.3 million of the increase with leisure and tourism increasing by £3.7 million. Total costs have increased by just under £21 million (about 33 per cent) in the six years, moving from £64.2 million in 1988 to £85.2 million in 1993. The Grant taken up in the accounts in the year has increased from £43.2 million in 1988 to £49.8 million in 1993, an increase of £6.6 million or 15 per cent. The lower rate of increase in the Grant than in total costs is accounted for by the increase in income.

4..15. Table 4.3 shows BWB income and operating costs in the six years to 31 March 1993 at 1993 price levels. The retail price index (RPI) has been used to convert out-turn prices to 1993 price levels. Whilst this index may not be wholly appropriate, it does show that in general BWB has been able to increase its income in real terms and at the same time hold operating cost increases within the level of inflation which has occurred in the six-year period.

TABLE 4.3 **BWB: operating costs in the six years to 31 March 1993 at 1993 price levels**

£'000

	1987/88	*1988/89*	*1989/90*	*1990/91*	*1991/92*	*1992/93*
Income (other than Grant) at 1993 price levels*	27,992	26,583	28,608	29,299	29,712	33,904
Total operating costs at 1993 price levels*	82,980	77,994	78,070	80,488	78,870	82,866

Source: MMC from information in Table 4.2.

*The RPI has been used 1993 = 100	135.4	127.7	118.5	108.0	103.1	100.0

Capital employed

4..16. The capital employed by BWB at 31 March 1993 as shown in the annual accounts is set out in Table 4.4.

TABLE 4.4 **BWB: capital employed at 31 March 1993**

		£'000
Fixed assets less depreciation		180,794
Current assets less current liabilities		2,764
		183,558
Financed by:		
Provisions		247
Deferred income		8,347
Capital and reserves		
Loans from Secretary of State	19,152	
Investment properties revaluation reserve	121,964	
Realized capital reserve	34,774	
Profit and loss account adverse balance	(926)	174,964
		183,558

Source: MMC from BWB Report and Accounts.

Properties which are no longer used for operational purposes are classed as investment properties. The balance sheet at 31 March 1993 reflects the open market valuation as at that date with the difference between that value and book value being shown in the Investment Property Revaluation Reserve.

Performance-current cost accounting basis

4..17. BWB is required, under the Direction of the Secretary of State, to produce a supplementary set of accounts which reflect the effect of changing prices in the form of current cost accounting information. To conform with this Direction, BWB has prepared current cost accounts in accordance with the principles set out in the Statement of Standard Accounting Practice No 16. This statement of accounting practice was suspended in June 1985 and formally withdrawn in April 1988. The Accounting Standards Committee has reaffirmed its view that where historical cost accounts are materially affected by changing prices, information about the effects of changing prices is necessary for an appreciation of company results and financial positions. BWB is, however, a grant-funded organization which does not and is not expected to achieve an overall return on capital employed whether the return is struck on an historical cost basis or current cost basis.

4..18. In producing its current cost profit and loss account BWB makes only two adjustments:

(a) depreciation adjustment-the difference between the current cost and historical cost depreciation; and

(b) fixed asset disposal adjustment-the difference between current cost and historical cost net book value of disposals during the year.

These are illustrated in Table 4.5.

TABLE 4.5 **BWB: effect of current cost adjustments on the annual results**

£'000

	1987/88	*1988/89*	*1989/90*	*1990/91*	*1991/92*	*1992/93*
Historical accounting basis profit for year-Table 4.3	34	51	173	189	90	104
Depreciation adjustment	-1,034	-731	-967	-951	-924	-534
Fixed asset disposal adjustment	-104	-297	-39	-12	-102	-273
Current cost accounting basis deficit for year	-1,104	-977	-833	-774	-936	-703

Source: MMC from BWB Report and Accounts.

Financial and accounting structure and systems

4..19. BWB's Finance Department structure is decentralized with a number of headquarters functions responsible to the Director of Finance. The four Regional Managers are supported by Finance Managers. Each Finance Manager reports directly to the Regional Manager, but is functionally responsible to the Director of Finance. An organization chart setting out the Finance Department structure is at Appendix 4.1. The Commercial Finance Manager reports directly to the Commercial Director-his line manager. However, he also reports functionally to the Director of Finance.

4..20. Each of the regions is a self-accounting unit with all relevant accounting records maintained in the region. The accounting records at regional level include the general ledger for the region, debtor and creditor records, fixed asset records and other subsidiary systems such as the property management system. The regional Finance Manager is responsible to the Regional Manager for the production of budgets, monthly reports and the reports required by the headquarters Finance and Accounting Managers.

4..21. The headquarters finance and accounting staff are responsible for the routine headquarters accounting requirements, including management of the payroll function and headquarters finance. Apart from this role the Chief Accountant is also responsible for the co-ordination of the financial planning and Treasury management as well as the consolidation of the regional and headquarters results.

4..22. The accounting procedures and recording systems, most of which are computerized, have been further developed over the last three years using standard software packages. The regional and headquarters Finance Managers told us that they are generally satisfied with the operation of the systems and the range of outputs available to them. Management information at waterway, regional and headquarters level is available in the format and timing required. The cost of and procedures used to control the development of the systems are more fully described in Chapter 7.

Financial planning and budgeting

4..23. The business plan guidelines which incorporate budget instructions are issued in May/June of each year. Plans are required from each region and division. These plans are reviewed on an informal basis by regional/departmental managers and executive directors during the period July to September of each year and are submitted to headquarters in October.

4..24. The plans and budgets are reviewed by the Chief Executive and are used as a basis for the production of the Corporate Plan which is submitted to the Board in draft form in February each year and in final form in March. The final version is submitted to the DoE at the end of March. The Corporate Plan covers four forward years, the first of which is the budget for the ensuing year. The budget year of the plan reflects the Grant notified by the DoE in the previous October/November. The budget is used at waterway, regional, divisional and headquarters level to monitor actual performance throughout the year.

4..25. Included in the guidelines for each region are target net results for the budget year and two forward years. The final two years of the business plan are left open. In addition to the net result target, other performance targets are set for each region. These include an hourly productive rate, direct costs per kilometre of waterway, the waterway and regional office cost ratio to the sum of the regional income and expenditure, absenteeism, overtime, waterway standards and safety.

4..26. Both the budget and the three succeeding plan years go down to the individual waterway level of detail. These are then summarized to a regional and subsequently to a group level. The three `plan' years are mainly concerned with the revenue aspects of operations, concentrating on income and expenditure levels. Some information in total is required on capital expenditure. The information for the budget year extends into a more detailed capital expenditure programme down to a scheme level of over £100,000, projected cash flows and a balance sheet budget. These budget items are at regional level. The Corporate Plan deals primarily with the revenue aspects of the plan, together with capital expenditure. More information on the Corporate Plan is given in Chapter 3.

Property sales and capital expenditure

4..27. Since 1987/88, as part of implementing its IBS, BWB has been disposing of some of its former freight-related property assets and reinvesting the proceeds in assets appropriate to its current objectives. The historic cost of these assets in the accounts was set at the time of the Board's formation in 1962 and, therefore, is now very low in relation to their current value. To adjust for this BWB has made interim valuations of its investment property annually with independent valuations every five years. The change in value is taken to an unrealized profit reserve called the Investment Property Revaluation Reserve. The balance on this reserve account at 31 March 1993 was £122.0 million and the book value of investment property was £137.7 million. The cost of the investment property was, at the same date, £15.8 million. Until the introduction of a new Financial Reporting Standard No 3 in 1992/93, BWB used the historical cost accounting convention to account for profits on disposal. As a result it reported profit over historical costs of over £25.1 million on its sales of property over the six years to 1992/93. Of this surplus some £5.7 million is attributable to the difference between the proceeds of disposal and the revalued value. In summary over the six years BWB has, from property transactions, realized some £19.4 million (£25.1 million less £5.7 million) of its investment property revaluations and added £5.7 million to its resources. BWB has thus geared up its revenue-earning potential-which we were told was one of the objectives of the IBS. Table 4.6 summarizes the historical cost profits on sales of businesses and property over the six years to 1992/93.

TABLE 4.6 **BWB: summary of profits on sales of businesses and property**

£'000

	1987/88	*1988/89*	*1989/90*	*1990/91*	*1991/92*	*1992/93*	*Total for the six years*
Profit on disposal of investment properties	5,287	2,936	3,968	2,711	6,149	4,095	25,146
Premium on long leases	458	75	909	354	471	692	2,959
Net profit on disposal of warehousing business	-	3,521	-	-	-	-	3,521
Sale of rights over operational property	-	-	6,910*	-625	-718	-826	4,741
Provision against loan to Limehouse Developments	-	-	-	-	-1,793	-392	-2,185
Add back charge to profit and loss account	-	-	-	-	-	392	392
Premiums retained in profit and loss account	-458	-75	-909	-354	-471	-692	-2,959
Transferred to realized capital reserve	5,287	6,457	10,878	2,086	3,638	3,269	31,615

Source: MMC from information supplied by BWB.

*The NPV of the deferred consideration relating to this sale was transferred to capital reserve and released to the profit and loss account in line with scheduled cash receipts.

Net cash flow generated by BWB on sales of businesses and property over the six years from 1987/88 to 1992/93 amounted to £31.6 million. This is the net profit after providing £2.2 million against loans to Limehouse Developments Ltd and after retaining premiums totalling £3.0 million in the profit and loss account.

4..28. Apart from the cash made available to BWB from disposals of its businesses and property, BWB receives as part of its Grant an element to cover capital expenditure. It also has the annual depreciation provision as a funding source. Table 4.7 summarizes the flow of funds available to BWB and the investment of those funds over the six years to 1992/93.

TABLE 4.7 **BWB: summary of capital expenditure and investments**

£'000

	1987/88	*1988/89*	*1989/90*	*1990/91*	*1991/92*	*1992/93*	*Total for the six years*
Funding							
Receipts from property disposals	5,495	2,936	4,281	2,712	7,285	4,379	27,088
Receipts from freight division disposal	-	954*	1,122	1,235	1,358	1,493	6,162
Capital element of Grant from DoE	1,818	1,578	957	1,300	1,050	905	7,608
Net depreciation*	1,726	1,560	1,895	1,862	1,930	1,587	10,560
Total funding	9,039	7,028	8,255	7,109	11,623	8,364	51,418
Capital expenditure and investments							
Capital expenditure investment property	234	867	1,443	1,390	1,253	3,542	8,729
Operational property	3,557	1,311	1,979	2,590	6,654	3,206	19,297
Craft plant and equipment	2,458	4,152	2,264	2,617	1,683	2,070	15,244
	6,249	6,330	5,686	6,597	9,590	8,818	43,270
Investments							
Joint ventures	450	680	-	1,036	833	392	3,391
Total capital expenditure and investments	6,699	7,010	5,686	7,633	10,423	9,210	46,661
Balance-used for/drawn from (-) working capital etc	2,340	18	2,569	-524	1,200	-846	4,757
	9,039	7,028	8,255	7,109	11,623	8,364	51,418

Source: BWB.

*The Freight Division disposal figure for 1988/89 is net of closure costs of £688,000.

4..29. Over the six years BWB had a total cash flow of £51.4 million and invested by way of capital expenditure and joint venture arrangements £46.7 million. The balance of £4.8 million was mainly used to reduce debt to the NLF. The total capital expenditure on property was £28.0 million. Of this £10.4 million is attributable to the Willow Grange headquarters (£9.4 million) and the Midlands and South West Region headquarters at Fazeley (£1.0 million). Capital expenditure on craft, plant and equipment was £15.2 million. There is no presumption that property disposal proceeds must be used for reinvestment in property. The disposal proceeds are considered as part of the general funding available for capital expenditure.

4..30. In general, BWB appears to follow the principle that property disposal proceeds must be utilized within the year in which they arise. This avoids the danger, inherent in Government rules, that cash surplus to the year's requirements must either be paid over to the Government or be used to reduce the following year's draw-down of the Grant.

4..31. Table 4.8 shows investment property disposal proceeds awaiting cash investment at the end of each accounting period for the year 1992/93. The trend in the balances indicates BWB's practice to begin to close down on disposal activity soon after the end of the first six months so that all monies can be reinvested before the year end. The disposal proceeds awaiting investment fall to zero by the end of the year.

TABLE 4.8 **BWB: property disposal proceeds awaiting investment-accounting periods 1 to 12 in the year to 31 March 1993**

Accounting period	*£'000*
1	8
2	384
3	1,844
4	1,940
5	2,651
6	3,066
7	2,983
8	1,252
9	1,460
10	1,590
11	1,771
12	-

Source: BWB.

4..32. BWB told us that, although it does invest in some multi-million pound projects, there is a need to ensure an adequate supply of smaller investment proposals which can be completed in the year. Larger investment proposals which may extend over a number of fiscal years have to be planned well ahead and this means that the exploitation of unforeseen opportunities is either inhibited or those opportunities have to be artificially `unbundled'.

4..33. With the lead times involved in disposals and investment projects the need to balance cash flows within the fiscal year was recognized as a constraint. The DoE introduced the following into the Financial Memorandum setting out the DoE arrangements with BWB:

> It is recognised that in seeking to maximise income from its estates portfolio, the Board may find it difficult to match precisely income in the form of receipts from estates transactions with planned re-investment opportunities. Whilst the Board's estimated receipts will be taken into account, and fixed asset investment levels set, in the annual Investment and Financing Review, the Department and Treasury will operate a presumption in favour of allowing the Board to use surplus receipts to increase its planned expenditure on fixed assets in the current year or subsequent years by up to £5m in total, provided:
>
> a. the Board can demonstrate that the increased expenditure is to maintain or enhance progress in implementing the agreed integrated business strategy; and
>
> b. any surplus receipts from estates are first applied in the year in which they arise to any shortfall in that year of expected income in the Board's other activities, to enable planned expenditure in those activities to be maintained.

BWB told us that disposal receipts surplus to the current year's reinvestment requirements, unless caused by an excess over the budgeted disposals figure, would be treated as a shortfall in expenditure rather than a surplus of disposals and therefore could not be carried forward.

4..34. There appears to have been some misunderstanding between BWB and the DoE on the interpretation of the arrangements (see paragraph 3.37).

Control of working capital

Year-end cash position

4..35. At the recent year ends up to March 1992 BWB recorded a £2.7 million overdraft in its cash book records. This overdraft figure coincided with the short-term borrowing limit in the EFL. We have been informed that BWB only went into overdraft at year ends. During the rest of the year, as illustrated in Table 4.9, the cash book balances are positive.

TABLE 4.9 **BWB: cash book position at period end for 1991/92 and 1992/93***

Accounting period	*1991/92*	*1992/93*
		£'000
Opening	-2,802	-2,734
1	-196	841
2	1,481	2,316
3	3,011	4,288
4	4,632	4,457
5	4,545	4,878
6	3,590	3,347
7	3,065	2,655
8	3,841	3,272
9	1,378	798
10	2,574	2,438
11	2,925	4,413
12	-2,734	-1,144

Source: BWB.

*The figures include property disposal proceeds awaiting investment.

Note: - = Overdrawn.

4..36. BWB told us that the DoE has agreed that unforeseen short-term borrowings may be incorporated as part of the working capital and not treated as temporary borrowings within the EFL. At the end of March 1993 this has effectively reduced the EFL by the short-term borrowings of £2.7 million. The DoE has assumed in the cash position returns that there will be a zero balance that is, neither an overdraft or a cash in hand position in BWB's cash records. BWB has stated that, in order to achieve the overdrawn position of £2.7 million in previous years and thus protect the short-term borrowing element of the EFL careful handling of payments to creditors was necessary. To avoid problems of funding failure described in paragraph 4.11 BWB has on occasion, at year end, paid invoices for work already completed and satisfactorily certified and invoiced promptly as opposed to taking the full credit period available.

Trade debtors

4..37. Table 4.10 sets out for the years 1991/92 and 1992/93 the doubtful debts provision, the current debtors net of the provision and an estimate of the debtors for rent included in the current debtors. Debtors for rent constitute between 66 and 70 per cent of the current debtors. BWB told us that rents due in advance constitute over 90 per cent of the South East Region rent roll. This region accounts for approximately 50 per cent of BWB's total rents. BWB has not been able to provide a figure of rents due in advance included in the debtors for rent. On the basis of the statistic extracted for the South East Region, we have estimated that overdue rents in advance amounted to £4.2 million and £5.0 million at the end of 1991/92 and 1992/93 respectively. Rents in advance are by definition payable on or before the due date (normally the quarter day, eg 25 March). In theory, therefore, there should be no outstandings in respect of rents in advance at period or year ends. BWB told us that most of its leases do not contain any penalties for late payment of rents in advance. Steps are being taken to incorporate the possibility of charging interest on late payments but BWB regards this as likely to have minimal effect with maximum administrative problems.

TABLE 4.10 **BWB: analysis of debtors and doubtful debts at period end for 1991/92 and 1992/93**

£'000

	1991/92			*1992/93*		
Accounting period	*Doubtful debts provision*	*Current debtors net of provision*	*Rent debtors included in current debtors*	*Doubtful debts provision*	*Current debtors net of provision*	*Rent debtors included in current debtors*
Opening	-1,183	5,887	-	-1,029	6,973	4,693
1	-1,188	3,802	-	-1,048	3,901	2,230
2	-1,163	3,808	-	-1,046	3,546	2,007
3	-1,095	6,133	-	-1,031	4,540	3,472
4	-1,090	3,340	-	-1,018	3,218	2,758
5	-1,096	2,710	-	-1,017	3,930	2,121
6	-1,095	5,710	-	-952	7,487	5,827
7	-1,083	3,631	-	-937	4,210	2,699
8	-1,079	3,292	2,218	-894	3,733	2,287
9	-1,067	5,510	4,684	-892	7,072	5,541
10	-1,084	3,455	2,116	-892	5,161	3,051
11	-1,075	3,296	1,715	-1,006	3,897	2,255
12	-1,029	6,973	4,693	-1,013	7,982	5,584

Source: BWB.

Note: The analysis between trade and rent debtors was not available in periods 1 to 7 1991/92.

4..38. Doubtful debts constitute some 11.2 to 12.5 per cent of total trade debtors at the year end. Trade debtor statistics, showing the value of debtors (including doubtful debts) in age categories ranging between 0 and 180 days and over 180 days, are reported using a series of charts, through the management hierarchy up to the Board. Procedures are in place for authorizing bad debt write-offs. Write-offs over £5,000 require the approval of the Chief Executive. Depending on the circumstances, bad debt write-offs may be reported to the Board. There is no detailed monitoring at Board level of additions to, recoveries from and write-offs of doubtful/bad debts, although the Treasury Manager is responsible for monitoring and reporting on doubtful debts to the Director of Finance.

Museum shop-cash receipts control

4..39. Annual sales of the museum shop are running at £210,000. Control on cash receipts is effected by:

(a) the application of a rule that all sales must be put through the cash tills; and

(b) the recording of sales by price bands for each item.

BWB recognizes that there are a number of problems associated with these procedures. In the first place they rely upon all sales being recorded at the proper price band through the cash tills. This is not necessarily always the case, especially in heavy selling periods. Secondly, the price bands are too wide to give anything other than a very general indication of the retail value of sales and there is bound to be a difference when each band of sales is converted back to cost of sales. As a consequence, control on both cash receipts and stocks is not as strong as it could be. These problems would be overcome if normal retail procedures were adopted requiring stock records-both receipts and issues-to be maintained at retail selling price as well as at cost. BWB is undertaking a review of shop stock procedures with a view to introducing tighter controls by April 1994. The suggestion will be taken into account at that stage.

Cost analysis and reporting

4..40. The collection and reporting of costs within BWB for its own management purposes strongly reflects the theme that budgetary control within BWB is by management responsibility. Costs which can be directly identified are charged out to the incurring or controlling project/department. Departments are therefore not charged with apportionments or allocations of expenses which they cannot control. For example, accommodation charges at Willow Grange are managed by the Facilities Manager and the costs are not recharged.

4..41. The Directions given by the Secretary of State in respect of the annual accounts requires that they shall disclose the turnover and other operating income, and operating costs analysed between the following activities:

(a) provision of docks facilities; and

(b) operation and maintenance for each of the following:

(i) multiple-use waterways;

(ii) leisure waterways; and

(iii) waterways not fully navigable.

The Direction for the 1992/93 accounts was different from previous years when essentially the activities were analysed between commercial, cruising and remainder waterways, Sharpness Dock and investment properties.

4..42. For the purposes of meeting the reporting requirements in the published accounts, costs are apportioned as follows:

Department	*Allocation method*
Region:	
Waterways	Direct
Waterways offices	Waterway length (kms)
Repair yards	Waterway length (kms)
Stoke Bruerne museum	Grand Union Canal (leisure)
Nantwich Marina	Shropshire Union (leisure)
Commercial	Income
Engineering	Major works plus contract
Finance	Income plus expenditure
Regional Manager	Income plus expenditure
Headquarters:	
Engineering	Major works
Commercial	Income
Human resources	People
Other admin departments	Income plus expenditure
Non-departmental	Direct

Source: BWB.

4..43. In the 1987 MMC report, the Commission recommended that greater use should be made of expenditure, revenue and usage analysis so that BWB could aim to improve the relationship between expenditure, income or usage. BWB's Statement of Objectives agreed with the DoE in July 1984 placed emphasis on the requirement that BWB should run its affairs on a commercial basis as far as practicable and amongst other things should secure an adequate rate of return on specific activities. BWB's present cost allocation methods do not relate costs to actual income streams and to those services which are funded wholly from the Grant.

4..44. In its Fifth Report Session 1988/89, the Parliamentary Committee on the Environment commented as follows:

> Given the history of the system, it is unlikely that the Board can ever run its affairs on a wholly commercial basis. Much of the value of the canal network to the community at large lies in its land drainage functions and unquantifiable environment benefits. It is therefore inevitable that BWB will continue to rely on public funds for a significant proportion of its annual turnover. This should be provided as far as possible by a `service fee' instead of Grant in Aid.

The 1987 MMC report recommended that consideration should be given to splitting BWB's Grant between revenue- and non-revenue-earning activities. In evidence to the Environment Committee in 1989 the DoE Minister responsible for BWB said that the Government accepted the need to give the Board as much future assurance about the Grant as was compatible with public expenditure planning requirements but saw difficulty in making a practical distinction between revenue-earning and non-revenue-earning activities in the payment of the Grant. Indeed, as the Government response to the Environment Committee report indicates, there appears to be some scepticism about the `service fee' route. The Government response indicated that the introduction of a `service fee' in place of a Grant would require much fuller and more reliable quantification of benefits and that current techniques were not sufficiently developed to provide this. The response continued that the Government remained to be convinced that the `service fee' route provided either a practical or desirable basis for determining Exchequer payments to BWB.

4..45. The analyses of costs produced by BWB and described in paragraphs 4.40 and 4.41 do not attempt to relate the costs incurred for the generation of specific streams of income to those income streams; nor do they establish the costs of those functions of BWB which benefit the community at large, namely its land drainage, public safety, heritage and environment functions as opposed to those which benefit specific interests such as the provision of cruising and commercial navigation facilities, moorings and angling facilities. Progress towards the establishment of a service fee basis for funding those services for the community at large which are not, at present, charged to the user depends to some extent at least on BWB's ability to establish the cost of those services.

4..46. Some 60 per cent of BWB's total costs are incurred in major revenue works and maintenance. BWB's Maintenance Management System is designed for the allocation of this range of expenditure to major works and jobs. The use of an appropriate classification which could be allocated at the time the project cost record is opened in the maintenance management system for each major work and job would enable costs of all major revenue works and maintenance to be allocated to the following groups:

(a) basic costs-those functions which benefit the community at large primarily drainage, public safety, heritage and environment;

(b) those costs related to maintaining/bringing back a waterway up to a navigable state for cruising boats;

(c) those costs incurred in the provision of moorings which could include sanitation and other similar service provisions;

(d) those costs associated with bringing navigable waterways to commercial use; and

(e) those costs associated with angling including special towpath maintenance and stocking of waterways.

Costs do, of course, overlap and it is inevitable that some judgmental decisions will be necessary in their allocation under this or indeed any system. Waterway operating costs and waterway office and regional office overheads could be allocated to categories *(a)* to *(e)* above on an appropriate basis. For example, lock manning for commercial traffic could be allocated to category *(d)*. The additional accounting work involved is:

(i) codify each project to enable information on cost to be collected under each cost grouping; and

(ii) more detailed allocation of operational costs.

With fully computerized procedures already available to aggregate costs, it is unlikely that any significant addition to staff would be required to implement these arrangements.

4..47. Administrative costs which constitute about 11 per cent of BWB's total costs could be considered for allocation on an appropriate basis or, alternatively, be left unallocated to be covered by the overall surplus of income plus Grant less expenditure.

4..48. Where income can realistically be allocated to a waterway or region, such as mooring income or angling fees, then profit and loss contribution statements could be struck at that level. However, some types of income arise from the use of the canal system as a whole, for example cruising licences. In such cases both income and related costs might have to be accounted for on a whole system basis. At present all income, with the exception of the Grant, is allocated to waterways. Whichever procedure is followed it must be recognized that there is unlikely to be any solution which will give absolute precision.

4..49. The cost allocation approach outlined above is close to an outline proposal very recently made by one of BWB's consultants. The essential difference is that the consultant's outline envisaged a much wider core activity than that associated only with drainage, public safety, heritage and environment taken as the core activity in paragraph 4.46*(a)*.

4..50. Clearly this approach to allocating costs will require some time to establish. Nevertheless it could provide a mechanism for BWB to progress towards a more commercial contractual relationship with the DoE based on cost plus or fixed price contracts or as proposed by consultants on an RPI-X basis, rather than the existing Grant.

4..51. A system adjusted to BWB's somewhat different organization and function but similar to that used by the former Department of Energy and the United Kingdom Atomic Energy Authority would enable the DoE and BWB to contract a future work programme. At the same time the flexibility required by the Government on the total public funds to be spent in any year would be retained.

Funding other than Government grants

4..52. BWB receives support in two ways from local authorities, development boards, the European Regional Development Fund (ERDF), trusts and other grant-making bodies, which we refer to in this section collectively as `other funding bodies'. In some cases funds are made available directly to BWB, and BWB then becomes responsible for contracting for, controlling and paying for work done. Support received in this way from funding bodies is recorded in BWB's accounts, although the accounting treatment has been changed for the year 1992/93. Prior to that year any grants received were treated not as income but as a deduction from BWB's operating costs. BWB's operating costs therefore represented the net cost after deducting these funds. In 1992/93 funds received from other funding bodies have been shown as part of `other income', and costs shown gross. In other cases support from other funding bodies is controlled directly by the relevant body or its delegated agent and the contractual arrangements, control and payment rests with that body. BWB does not include these transactions in its accounting record nor does it formally maintain information on this type of support. The value of work funded by other bodies in 1992/93 amounted to £6 million, equivalent to approximately 12 per cent of the Grant. Details are given in Table 4.11.

TABLE 4.11 **BWB: work funded by other bodies 1992/93 other than grant-in-aid**

£'000

Region	*Amounts passing through BWB accounts*	*Amounts not passing through BWB accounts**
Midlands	1,787	868
North East	85	452
North West	359	950
Scotland	388	16
Southern	451	617
Total	3,070	2,903

Source: BWB.

*As these do not pass through BWB accounts, BWB is reliant upon estimates and financial data supplied by the various funding organizations.

4..53. BWB funds its statutory responsibilities by Grant and third party income. It is able to maintain a remainder waterway at a higher standard only if the additional cost is paid for by a third party. This is usually a local authority but has occasionally been a canal trust. BWB has told us that it is generally willing to maintain its waterways or towpaths at a higher standard than it would normally do, if so requested by a local authority, providing the local authority is willing to pay the extra cost involved. BWB would also make one-off improvements on a similar basis whether these are 100 per cent financed by the local authority or partly through ERDF grant. The ERDF funds received are in respect of improvement works which would normally be regarded as capital, even though they may not be treated as such in BWB accounts. Under the new rules recently introduced, ERDF grants can be received without being offset against Grant provided they have been forecast in the IFR bid for the year concerned. ERDF funds are only available to carry out non-statutory works.

4..54. BWB told us that in its budget and Corporate Plans, it takes account only of maintenance agreements and external funding which is ongoing or otherwise agreed. As the works involved are outside the scope for which Grant is provided by the Government, there is no link between these funds and the Grant. Should any funding of this nature be included in a budget and subsequently not received, BWB would not carry out the works involved.

4..55. With its corridor studies and other programmes directed at local authorities and other similar funding bodies BWB actively encourages the support of these bodies. However, the lack of explicit provision in the budget/Corporate Plan targeting support from other funding bodies means that what might be one of BWB's principal budget/Corporate Plan objectives is not formally recognized in its plans.

Audit

Internal audit

4..56. The Internal Audit Department consists of the Head of Audit with six supporting staff, one of whom is at present on secondment to management accounts. The Head of Audit reports to the Chairman and the Audit Committee for direction and to the Director of Finance for professional standards and logistics.

4..57. The principal activities of the Internal Audit Department cover:

(a) compliance audit-ensuring that appropriate procedures and systems are in place and measuring the degree of compliance with them;

(b) attainment audit-measuring the depth of achievement of objectives and the reliability and integrity of transactions and events;

(c) value-for-money audit-reviewing the security and efficient and effective use of resources; and

(d) investigation of fraud and suspected irregularities.

Importance is attached to liaison between external and internal auditors with the objective of maximizing the use of audit resources and coverage and avoiding duplication of effort.

4..58. In addition to the activities outlined above, the Chairman has used the Head of Audit to lead reviews on specific topics. These have included:

(a) engineering works identification and prioritization;

(b) planning and operational control in the waterways;

(c) commercial aspects of regional activities; and

(d) liaison with the MMC on section 11 Competition Act references.

Audit Committee

4..59. The Board has appointed an Audit Committee of non-executive directors chaired by the Deputy Chairman. The Head of Audit acts as Secretary. The Chief Executive and Director of Finance attend by invitation as do other executive directors for appropriate matters.

4..60. The Committee usually meets about three times a year. It receives reports on:

(a) the annual accounts;

(b) the management letter from the external auditors;

(c) the Board's response to the DoE;

(d) the internal audit plan; and

(e) progress in achieving the internal audit plan.

Over the period from April 1988 to 1992 the Head of Audit has reported shortfalls against his planned programme to a lesser or greater extent. In their management letters of 1989 and 1990, the external auditors commented on the need to increase the level of internal audit resources. One of the problems in implementing the audit plan came from staff vacancies as junior staff moved to more senior positions elsewhere on achieving professional qualification. In addition to planned work, the *ad hoc* projects, although approved by the Audit Committee, have nevertheless affected the level of resource available for the audit programme. There is little sign that the level of *ad hoc* work given to internal audit is abating significantly.

External audit

4..61. External auditors are appointed by the Secretary of State as required by the 1962 Act. The Board is required to send a copy of the Accounts and the report made by the auditors to the Minister.

4..62. The external auditors regularly explain the scope of their audit and their findings to the Audit Committee. The external auditors are required to report by a management letter any significant matters arising in the course of their work. Additionally, the auditors are required to identify areas for specific value for money audits, annually reporting on this and other audit matters to the Board in the first instance. Over recent years the external auditors have rarely been requested to carry out any value for money investigation from the list identified in their management letter. The majority of such areas, however, have been addressed by BWB itself.

Performance indicators

4..63. Performance indicators are not included in BWB's Annual Report and Accounts. The only statement relating to financial performance itself is the note shown on the profit and loss account (in accordance with the accounts Direction) on the EFL and the out-turn external financing requirement. On the other hand, as outlined in paragraph 4.25 and Appendix 3.2, BWB does set performance targets such as:

(a) the revenue grant as a percentage of total expenditure including interest; and

(b) income from leisure and industrial/commercial activities contributions to maintenance, as a percentage of total waterway costs.

BWB also produces statistics on the cost per kilometre of waterway maintenance. Such indicators may not be wholly adequate in making short-term comparisons but their strength lies in looking at the trends over a period of, say, five years. These can demonstrate whether matters are improving or otherwise.

Conclusions and recommendations

Rules on treatment of investment property disposal proceeds

4..64. The disposal of property and investment of the proceeds is characterized by a timetable under which most disposals are effected soon after the end of the first six months of each year and all the proceeds are invested before the year end. This avoids problems which may arise to BWB should it hold unutilized funds at the end of the financial year. It does, however, act as a constraint on the use of funds in those projects which might extend over a year and/or which require larger amounts of investment. We conclude that the rules which permit the carry-over of such proceeds from one year to the next are less effective than intended.

4..65. We recommend that BWB should seek revision of the rules with the DoE to remove confusion on the current rules.

Debtors for rents payable in advance

4..66. At the end of 1992/93 trade debtors stood at £7.9 million, some £5.0 million of which we estimated were in respect of rents payable in advance. We conclude that BWB could reduce the level of capital employed by better performance on collection of rent in advance.

4..67. We recommend that BWB should insist on strict enforcement of its payment in advance terms and take steps to ensure that current and future rental contractual arrangements permit effective penalties for failure to pay on time, unless under dispute.

Monitoring of doubtful debts

4..68. We conclude that doubtful debts and current debts could be more effectively controlled by separate monitoring and control of each category and by an enhancement of the report to the Board on doubtful debts.

4..69. We recommend that there should be regular monitoring of doubtful debts to ensure that timely action is taken for recovery and that information on movements in doubtful debts and on write-offs should be submitted to the Board separately from the report on current debtors included with the financial reports.

Cost analysis and reporting

4..70. The existing cost allocation system provides costing information on a waterways basis. There is little or no regularly available information which enables BWB to separate the cost of providing its public amenity services such as drainage, public safety, heritage and environment from the costs of providing chargeable facilities for cruising, mooring, commercial navigation and angling. We conclude that a successful integrated strategy for BWB's business depends on analyses of the costs and benefits for each service it provides.

4..71. We recommend that BWB should develop a costing system which identifies the costs of providing the basic public amenity services and separates the costs associated with the provision of chargeable user facilities. This would assist BWB in identifying the value of those of its activities for which there is no specific income stream.

Grants and maintenance contributions other than grant-in-aid

4..72. We conclude that some of the most effective developments on the waterways are those either wholly carried out by local authorities and other funding bodies or carried out by those bodies with the involvement of BWB. Moreover, we believe that the willingness of other funding bodies to participate measures the value to the `public good' of improvements in public amenities.

4..73. We recommend that:

(a) BWB strategy should give at least equal funding priority to co-operation with other funding bodies as it gives to the funding of ventures in which the private sector is involved;

(b) BWB should include as an annex to its Corporate Plan a statement setting out its plans for co-operative developments (being those other than involving its statutory obligations) with other funding bodies. This should cover the four forward years of the Corporate Plan. It is suggested that it should not be incorporated in the budget/plan to ensure that the level of Grant is not affected but the DoE should monitor progress on its achievement; and

(c) BWB should show separately any funding received from other funding bodies and which BWB currently includes in its accounts. Indirect funding from these bodies which is not included in BWB's accounts should be shown in notes to the accounts.

Internal audit

4..74. We conclude that the internal audit performance against its planned programmes has been affected by *ad hoc* projects and staff turnover which have not been fully anticipated in the planning of internal audit manning levels.

4..75. We recommend that the staffing levels of internal audit should take account of *ad hoc* projects and staff turnover. To assist this process, reasons for staff turnover should be recorded and analysed.

Performance indicators

4..76. We conclude that BWB should continue to develop a suitable range of indicators of performance for publication.

4..77. BWB should publish in its Annual Report and Accounts a series of indicators of performance covering the last five years.