

CIPFA Directors of Finance Section

To: The Education and Skills Committee, Scottish Parliament

From: CIPFA Directors of Finance Section

Date: 14 June 2017

Subject: School Infrastructure Inquiry

Introduction

1. The CIPFA Directors of Finance Section constitutes the 32 Directors of Finance ([section 95 officers](#) per the Local Government Scotland Act 1973) of Scottish councils.
2. The [Committee's inquiry](#) is indicated as being focused on the "inspection and remedial work of the school estate since early 2016 and the quality assurance practices for new school buildings."
3. While these matters are not within the direct responsibility of a Section 95 officer this paper is provided as a summary briefing, noting some related financial matters which the Committee may wish to consider.
4. This briefing primarily relates to financial issues and risks relating to investment in, and the financing of, school infrastructure. The Section fully recognises that ultimately it is the physical safety of pupils, teachers and other building users that will be foremost in the minds of the Committee.

Financing Arrangements

5. The Committee will be aware of structural issues with some City of Edinburgh Council schools (PPP1 scheme). The subsequent '[Report of the Independent Inquiry into the Construction of Edinburgh Schools](#)', led by professor John Cole MBE, considered the impact of the financing arrangement on the construction process.
6. The rationale for adopting a PPP financing method, under the previous 'section 94 consent' regime¹ whereby the amount that an authority could borrow was specified and externally controlled, was generally addressed in the Cole report for the scheme affected. It may be helpful to recognise that, from 1 April 2004 the section 94 regime was replaced² by the Prudential Framework³.
7. The report (3.1.12) stated "while the financing method was not responsible for the defective construction, aspects of the way in which the PPP

¹ Per the Local Government (Scotland) act 1973 section 94

² Under the powers established in [Part 7 of the Local Government in Scotland Act 2003](#) and exercised through [The Local Government Capital Expenditure Limits \(Scotland\) Regulations 2004](#) (SSI 2004/29)

³ The Prudential Code for Capital Finance in Local Authorities (CIPFA, 2011). The objective is to ensure that "the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice"

methodology was implemented on these projects did increase the risk of poor quality design and construction”.

8. The implication of this appears to be that the implementation and management of PPP schemes, rather than the mechanism of financing, is more directly relevant to the safety of related school infrastructure.
9. It may also be inferred that, as evidenced through other incidents, building safety failings can occur in traditionally financed school buildings.

Funding of Repair and Maintenance

10. As the Committee will be aware one aspect of PPP arrangements is that the Unitary Charge, the committed funding which an authority is required to pay to the contractor, normally includes payment for the maintenance of the asset throughout the contract life. In effect the budget or funding for maintenance is 'locked into' the contract.
11. This includes not just annual maintenance and repair tasks, but also 'lifecycle capital' tasks, such as boiler replacement, when these become necessary.
12. Potentially this may mean that regular reviews are necessary to ascertain that the contract conditions, regarding the condition and suitability of the asset, are being met. The contractor's responsibilities to ensure continued service provision are reinforced through deductions from the Unitary Charge in the event that the services provided by the asset are unavailable.
13. In the Edinburgh PPP1 scheme (noted earlier) the long term closure of the schools involved led to deductions for non availability of over £5m being levied under the contract against the PPP provider Edinburgh Schools partnership, with the required rectification works also being funded by the contractor at their cost.
14. This is a key aspect of the risk transfer mechanism associated with by PPP contracts whereby the contractor normally assumes some or all of the financial risks associated with non availability of the schools. This may occur for a variety of reasons including the need to close buildings to address health and safety or essential repair and maintenance issues. A contractor may seek insurance cover for some of these risks. In the case of the Edinburgh school PPP1 contract the associated payment deductions, whereby the whole of the unitary charge was at risk of deduction by the Council due to school non availability over a protracted period, would seem to have operated effectively and to have protected the council from financial loss.
15. This contrasts with traditionally financed school building projects, whereby the budgets, both for revenue repairs and capital lifecycle items, may be planned for but are not legally committed. As such the extent of budget required or allowed for repair and maintenance may be subject to decisions in later years concerning relative spending priorities.
16. Under a traditionally financed school build the extent to which the council is exposed to financial risk for repairs and maintenance will depend on a number of factors. The existence of warranties or guarantee clauses in the construction contract, the extent of insurance cover for building failure, and

competing budget priorities may all be factors affecting the financial risks for councils relating to repair and maintenance of school infrastructure.

17. The different contractual arrangements may therefore affect the financial risks, and the management of those risks, arising from repair and maintenance issues.
18. Management of the building safety risk to pupils, teachers and other staff would seem likely however to always require reference to an evaluation of the physical building, and appropriate action by the responsible party.

Quality Assurance

19. From Professor Cole's report it is understood that a key issue identified related to the quality assurance processes, particularly independent scrutiny, during construction⁴.
20. These matters are generally not within the direct responsibility of a Section 95 officer and will be subject to the professional judgement of the relevant professionals.
21. Such decisions may of course have financial implications for councils, for instance if additional recruitment of Clerks of Work is undertaken to increase council scrutiny during construction, whether under PPP or traditionally financed.
22. As indicated above in relation to repairs and maintenance, the available resources are likely to be affected by competing budget priorities, which ultimately will reflect the policy decisions of each council as determined by elected representatives. Such policy priorities may change over time, for example following changes in political control.
23. In considering the relative policy priorities consideration may be given to the difference in outcomes that are expected. While there is naturally normally a focus on positive outcomes or achievement, consideration may also be given to the prevention of negative outcomes e.g. the avoidance of harm to pupils, teachers and others.

PPP Contract Management Information

24. Under current accounting standards PPP schools are generally reflected on council balance sheets. Properly accounting for these assets is dependent on a clear understanding of the underlying reality of the arrangements. For example it is normally helpful to establish whether any 'lifecycle capital' works, such as a boiler replacement, have taken place during the year.
25. Consequently management information exchanges between the contractor and the contract manager may be anticipated. This may help a council to secure, and evidence, that the arrangement is providing the optimum Value for Money for the council as well as supporting an effective working relationship.

⁴ See ['Report of the Independent Inquiry into the Construction of Edinburgh Schools'](#) paragraphs 3.4.2-3.4.29