



*Leeds City Council
EASEL
KPMG LLP*

Leeds City Council

**EASEL
Regeneration project
Risk review**

KPMG LLP
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1 Introduction

1.1 Background

1.1.1 KPMG has undertaken the work reported on in this document as part of the KPMG External Audit of Leeds City Council (“the Council”).

1.1.2 The audit plan for 2005-2006 includes the review of certain key risk areas faced by the Council in relation to the East & South East Leeds (“EASEL”) regeneration project, which involves a proposed joint venture partnership (“JV”) between the Council and Bellway plc (“Bellway”).

1.1.3 The Council specifically identified the following key risk area in discussion with KPMG as the focus for our work: “The extent of access rights to enable the Council to monitor and control the activities and performance results of the joint venture vehicle.”

1.1.4 In a meeting on 27 February 2007, the Council set out the following specific objectives in relation to this key risk:

- Build confidence in what the JV vehicle is doing;
- Get the Board engaged;
- Achieve transparency of activities of the JV vehicle;
- Enhance competition and market testing;
- Translate “open book accounting” into a practical process; and
- Maintain relationships throughout such a process.

1.1.5 Further relevant indications of the Council’s objectives are set out in the “Preferred bidder letter” from the Council to Bellway dated 19 December 2005 which refers inter alia to:

- 6.3 “The Council requires equal governance of the project including ... selection of sites ... approval of Business Cases ... agreement of board members, external appointments ...”
- 6.5 “The Council require Open Book accounting of Bellway’s costs and the appointment of the independent cost consultant who would review Bellway’s costs and indicate whether these are higher or lower than market rates and review the development Business Cases that determine the Guaranteed Land Values to the Council.”

1.2 Scope

1.2.1 We have reviewed certain documents in relation to the EASEL regeneration project and have drawn on our experience of similar projects elsewhere to:

- Comment on structures and processes with reference to best practice and experience from the public and private sector; and
- Highlight potential pitfalls in processes which are typically considered, in the context of enhancing the extent of access rights to enable the Council to monitor and control the activities and performance results of the JV.

1.2.2 In particular, we have been asked to provide comments in relation to “open book accounting” (which we set out in section 2) and to provide guidance based on our experience of similar legal agreements (which we set out in section 3).

1.2.3 As the JV agreement has yet to be drawn up we comment on the issues relevant to our scope that the Council should consider in designing the JV agreement to assist in it meeting its objectives and establishing relevant controls.

1.3 Sources of information

1.3.1 We have based the comments set out in this report on our review of the following documents:

- EASEL Risk Register;
- East and South East Leeds Regeneration Area Development Brief;
- East and South East Leeds Regeneration Area Stage 2: Regeneration Brief;
- “Preferred bidder letter” from the Council to Bellway dated 19 December 2005; and
- “Preferred Bidder Letter” – Additional negotiation period, from the Council to Bellway dated 6 November 2006.

1.4 Summary of risk areas

1.4.1 We have considered the following specific key risk areas and “Existing control mechanisms” noted by the Council in the EASEL Risk Register:

- P2: “The structure of the JV Co or processes (planning, consultation, procurement) is subject to legal challenge” – “Seek and act on External advice for Technical, Legal (including procurement) and Financial matters.”
- P4 “Council are unable to agree appropriate governance arrangements for JV Co” – “LMT Discussions, EB Reports. Unlikely to occur if arrangements are in place for Member involvement and influence.”
- P7 “Once JV operational Bellway and LCC fail to operate as a partnership due to cultural differences and different objectives” – “Both parties need to ensure JV is established to operate on Commercial lines, with a clear mandate and delegations for all Board members.”

1.4.2 We consider all of the above to be relevant to our considerations because the control mechanism in each case refers to the legal arrangements for setting up the JV, which is where we envisage our comments may best be reflected.

- 1.4.3 In addition, we also consider the importance of risk H5 “Failure by both parties to dedicate sufficient resources / staff time to JV operations – direct and indirect.” The existing control mechanism against this risk appears to restate the issue rather than offer a solution: “Risk is of non-realistic expectations regarding what is required and can be achieved with the resources allocated. Likely that LCC will try to do things ‘on the cheap’ due to internal budget pressure.” We set out our comments in relation to this risk in the form of suggestions in section 2 regarding the operational management of the JV when it is up and running.

1.5 Caveats

- 1.5.1 The precise wording of the final contractual documentation is primarily a legal matter and may therefore reflect matters outside our knowledge or expertise. Our comments made as part of the audit should not be relied upon as suitable for incorporation into the final contractual documentation without consideration by the Council’s legal advisers.
- 1.5.2 The final contractual documentation will be the product of a negotiation process and will therefore contain clauses which reflect the interests and requirements of other parties as well as the Council. It is for the Council to decide whether, on balance, to accept those clauses in the circumstances.

2 “Open book accounting”

2.1 Introduction

2.1.1 The Council has specifically asked us to consider the issue of how to effect in practice the concept of “open book accounting.”

2.1.2 Our commercial experience of “open book accounting” includes work for:

- Large private companies who have outsourced particular services to third parties, sometimes with attendant transfers of staff;
- Other public bodies who have concluded that open book accounting and the attendant review processes are an essential part of their financial controls over a “third party provider” often, but not always, of outsourced services.

2.1.3 In our experience, such processes usually focus on the costs incurred by those entities as a means of enabling recharges or invoiced values to be assessed. Open book accounting may also be applied as a means of determining the appropriateness of profit sharing or allowing the adequacy of funding arrangements to be considered.

2.1.4 Our most frequent commercial experience of open book accounting in relation to income is in the context of intellectual property licensing arrangements, where licence agreements usually allow the licensor of intellectual property the right to conduct an audit of the timing, amount, completeness and accuracy of the royalty income being reported to them by licensees. Such royalties are typically calculated as a percentage of sales or profits made by the licensees.

2.1.5 The Council will doubtless face a situation similar to that faced by licensors or others who have handed over the management of their intellectual property or other services to a partner or “third party” with whom they are closely working. Like a licensor of intellectual property, or outsourcer of services, the Council will have limited control over the execution of their objectives and policies by the JV vehicle except in so far as it builds in, by agreement, requirements for the JV vehicle to do certain things or to obtain consent before being able to do certain things. This clearly makes the wording of legal agreements to be put in place crucial from the Council’s perspective.

2.1.6 The Council could use open book accounting to monitor the performance of the JV in a similar way to a licensor managing the performance of a license agreement. In practice, the Council’s principal means of managing the costs incurred by the JV and hence its own returns will be a combination of:

- Determining clear and concise wording for specific clauses to be included in the final legal agreements prescribing the appropriate bases on which such costs can be incurred and the extent to which they may be borne by the JV as opposed to by Bellway; and

- Exercising effective management of the rights conveyed by the legal agreements. An important tool in the Council's armoury is the effective use of access rights to enable visibility and monitoring of the extent to which the JV's financial and cash flow performance is in line with expectations, represents value for money, and is being calculated consistently with contractual requirements.
- 2.1.7 In our experience, JV's are often resourced at a management level by managers effectively seconded or transferred from one of the JV partners, usually on a full-time basis. In the event that those key members of management (including those responsible for financial management) consider that their "allegiance" is in effect to one JV party rather than to the JV itself, this can cause difficulties. In this case, we do not know the proposed arrangements for who will prepare and maintain the financial records of the JV and who will be responsible for ensuring that only relevant costs, properly incurred and representing value for money, calculated on a basis consistent with the legal agreements to be put in place, are included within the JV's accounting records. However, it will be important for the Council to understand who has these responsibilities at the JV and ensure there are appropriate clauses in the legal agreements to govern the practical operation of these responsibilities. In particular, in the event that a manager from Bellway is seconded, the legal agreement must clearly state that the individual's responsibility is to act in the best interests of the JV.
- 2.1.8 We have been asked to consider how access rights could be implemented in a way which would assist the Council to monitor and control inter alia the financial position of the JV. We have assumed, for this purpose, that the JV will maintain its own completely independent accounting records, rather than for example such records being maintained by Bellway on their own accounting systems. The latter would be likely to raise additional access challenges particularly if access were requested to electronic information since Bellway would naturally be concerned to ensure access to non-JV financial records is avoided.
- 2.1.9 Related to this, if the records of the JV are maintained on a separate ledger profit centre within Bellway, there is the risk that this artificial separation is not as effective as a more obvious separation by virtue of Bellway trading with a different entity. Accounting for transactions with a different legal entity tends in our experience to be more rigorously performed than, for example, internal journal transfers.
- 2.1.10 In light of all the above, the Council therefore needs to consider the methods it has to influence the costs incurred by the JV and the mechanisms both for securing an appropriate direct return and for ensuring value for money for goods and services delivered to the JV. Since it is clear from the documents provided to us that certain costs are not to be passed on to the JV it will also be important that access rights provide a means for the Council to satisfy itself as to compliance with such requirements. (For example paragraph 2.3 of the attachment to the 19 December 2005 letter from the Council to Bellway, says: "Bellway will provide funding of up to £4 million to set up and ensure the effective working of the joint venture for the first five years without further recourse to the Council for financial support and cover the basis for the incorporation of the joint venture, its initial working capital; its administration will be agreed with the Council at all material stages. The set up costs for the joint venture will not be a pre-emptive debt

on the accounts of the joint venture but will be funded by Bellway off the balance sheet of the joint venture and accounted for accordingly within the Bellway Group accounts.”)

- 2.1.11 The risk faced by the Council is that the costs which are not supposed to be passed on by Bellway to the JV are in fact passed on and are therefore shared by the Council when they ought to have been 100% to Bellway’s account. The practical issue is the ability of the Council to check Bellway’s compliance with the requirement to suffer certain costs itself.
- 2.1.12 The main methods available to the Council for meeting these objectives are:
- Influencing the management of the JV vehicle to follow certain courses of action (considered in more detail in section 3 of this report in the context of the contractual arrangements the Council will enter into);
 - Actively managing the process of receiving and reviewing information about the financial performance of the JV vehicle both as to profits and cash (considered in more detail in the remainder of this section).
- 2.1.13 The Council could also actively require that where goods and services are sourced by the JV from one of the JV partners (eg Bellway), there is a transparent process for ensuring such goods and services are procured on an arms length basis at market value or perhaps at cost or cost plus an agreed recovery. This in turn should be supported by an open book review process to check Bellway costs (consistent with paragraph 6.5 of the Preferred Bidder Letter). This is outside the scope of the matters on which you have asked us to comment in this report although we would be pleased to assist you further with these areas should you wish. Some of the concepts in relation to open book access to Bellway and review of costs incurred are not dissimilar to those relating to the Council’s open book accounting review of the JV.

2.2 **Reasons for errors in self-reported statements**

- 2.2.1 KPMG’s experience is that in the region of 70% of self-reported statements required for royalty licensing reporting are incorrect because of misreporting. We do not have comparable statistics for self-reporting for out-sourcing or joint venture purposes.
- 2.2.2 The broad categories of reasons for misreporting vary and are instructive in the context of the contractual arrangements the Council is considering. Although fraud is rare, it is one explanation. However, the reason is far more frequently plain error, or derived from a misunderstanding of what information was supposed to be collated and the nature of the calculations that were supposed to be based on that information.
- 2.2.3 In our experience, the most common detailed reasons for errors are:
- Misunderstood, complex and ambiguous agreements;
 - Failure of one or both parties to devote sufficient resources to managing the contractual relationship;
 - Systems weaknesses at both parties causing failure to support compliance with contractual obligations;

- Failure of an organisation (in this case the Council) to review self-reported information from its partner;
- Changes in circumstances between the date of the agreement and subsequent reporting, including corporate changes which have not been appropriately reflected; and
- Fraud (rarely).

2.3 **Building and managing a successful self-reporting relationship**

Commitment to a routine

- 2.3.1 In keeping with the Council's statement quoted at paragraph 1.1.5 above that it intends to impose a regime of open book accounting on Bellway, any legal agreement between the parties will of course need to contain an enforceable clause to allow it to monitor and audit the reporting regime.
- 2.3.2 It is clear from the documents provided to us that there will be advantage to the Council in similarly having open book accounting access rights over the JV to enhance its knowledge of the costs and revenues incurred by or attributed to the JV and thereby to assist the Council to monitor the JV's financial performance and the appropriateness of the information reported.
- 2.3.3 Because self-reporting relationships are based on at least a degree of trust between the participants, the subsequent actual enforcement of audit clauses can be interpreted as conveying mistrust. Participants in self-reporting arrangements can therefore be reluctant to enforce their audit rights.
- 2.3.4 Our suggestion, based on our experience, is that the enforcement of such rights should be presented as entirely systematic, a part of the normal practice of the Council, and not in any way selective. If it is properly articulated and managed from the start and regularly employed as a routine part of the governance of the relationship between the parties, there is less likelihood of the Council encountering resistance to such a process.

Active management

- 2.3.5 The key message in this context is that active management of the relationship is vital.
- 2.3.6 We recommend that the Council clearly allocates to someone the responsibility for managing the relationship with both the JV and Bellway. Those who influence the JV vehicle by involvement in its management and decision-making must actively exert from the start the influence conferred on them by any legal agreement.
- 2.3.7 We also recommend that responsibility should be given to other individuals within the Council to monitor information about the performance of the JV vehicle, which should be provided on a regular basis (see below). It is important that those who are to monitor are clear as to the exact information they should expect to see, and what an effective monitoring role should involve.

Flow of information

- 2.3.8 A requirement for regular provision of information in itself imparts a degree of routine to the whole self-reporting structure. The objective of the Council should be to instil a habit of openness which is achievable by requiring a general flow of information from the start. A regular review of the information, and raising of queries as and when appropriate, is an important next step. The relatively formal “audit” visit appears less of a nuclear option if there is already a flow of information and a dialogue about it.
- 2.3.9 The nature of the information which ought to be provided is discussed in section 3.

Use of third parties

- 2.3.10 There is of course a cost involved in using third parties to carry out “open book” “audits” but the use of an independent third party firm can be an effective way to break down barriers between parties operating a reporting relationship. An independent third party provides vital neutrality and can sometimes facilitate agreement over grey areas, ambiguities and misunderstandings.
- 2.3.11 An independent third party can also bring a greater degree of transparency to the relationship and help improve controls and procedures on both sides of the relationship. In addition, they may also bring insights from experience elsewhere which could have an effect of fast-tracking understanding of the contract performance.

3 Guidance from previous experience of similar legal arrangements

3.1 The role of the Agreement

- 3.1.1 Throughout this analysis we refer to “the Agreement” as a single document. The provisions we suggest as being appropriate may be contained in the Strategic Development Agreement or other associated agreements (such as possibly a Members’ Agreement relating to the conduct of the JV vehicle). The structuring of such legal arrangements is of course the role of lawyers and our focus is on aspects of the substance of the legal arrangements.
- 3.1.2 In the context of the general review of the relationship that would exist between the Council and the JV, and with Bellway, we set out in the remainder of this section 3 our comments on detailed provisions of the Agreement which we consider to be important.

3.2 JV Board

- 3.2.1 We have commented above that an aspect of the control the Council is able to exert over the JV is its involvement in management and decision-making. Typically this will be through involvement on the Board of the JV vehicle.
- 3.2.2 All major decisions should be made by a defined JV Board and in accordance with the provisions of the relevant clause or schedule of the Agreement. The actual running of the JV projects will of course be delegated by the JV Board. The important thing is to get the big picture right, for instance the constitution of the senior Board level of management and the decisions made by that level of management.
- 3.2.3 The membership of the JV Board should be set out in the Agreement as containing equal numbers of representatives of the Council and Bellway.
- 3.2.4 Matters decided by a majority vote should be passed only if the majority includes a representative of both the Council and Bellway. Likewise a quorum should include a representative of both the Council and Bellway.
- 3.2.5 There should be regular meetings of the JV Board and the facility for any member of the JV Board to call a meeting by giving say one or two weeks’ notice.
- 3.2.6 Consistent with our recommendations in section 2, the Council should ensure that the individuals it selects to represent it on the JV Board are fully engaged with the process and sufficiently knowledgeable and appropriately experienced to participate fully in discussions and decision-making. The key to successful Board representation is knowledgeable active involvement representing to good effect the views of the Council whilst recognising one’s obligations as a Board Member more broadly. Effective representation will also provide enhanced visibility to the Council.

3.3 Information about the JV's performance

Defining terms

- 3.3.1 Any words or terms which are key to the reporting of the JV vehicle's activities should be properly defined. The objective should be to achieve as much certainty as possible in the contractual terms.
- 3.3.2 Depending on the structure adopted for the provision of reports to the JV partners, a term like "Development Costs" will be important to define the expenditure which the parties accept may be set against the income due to them. Loose wording should be avoided. For example, phrases such as "Development Costs shall include ..." should be avoided since "include" implies that costs other than those listed can be included. "Development Costs shall comprise ..." is better since the list following such an introductory phrase can be regarded as absolute and complete.
- 3.3.3 We have in the past seen wording on the lines of "the Parties shall participate in a periodic financial review of the JV vehicle", which again is too loose to be useful without more detailed provisions in support. However, such a process is worth considering in addition to detailed protections, as discussed in paragraph 3.5.4 below.
- 3.3.4 A further issue in the context of recording the actual costs of development for set off against income is the avoidance or close definition of the allowance of "overheads" or similar. The cleanest approach is to allow only direct costs and not internal overheads or administrative expenses.
- 3.3.5 However, if some element of overheads is to be allowed, definitions of relevant costs should avoid vague terms like "estate costs" which could mean different things to different people. A detailed list of the costs that are allowed should ideally be provided, the agreement of which may entail considerable liaison with Bellway prior to signing the Agreement.
- 3.3.6 In relation to costs, there should be a general provision to exclude costs which have not been reasonably or properly incurred. Although such a provision does not offer certainty about the costs that are to be included, it does at least offer a route to challenge and possibly exclude unreasonable costs.
- 3.3.7 Consideration should be given to requiring the JV to have appropriate procurement and tender procedures in place designed to secure value for money, and to similarly require that Bellway follow such procedures in their own procurement of services for onward supply to the JV.
- 3.3.8 We have also seen use of the term "normal accounting treatments" of the JV partner. If this were to apply here, the Council should ensure it fully understands the accounting treatments concerned. However, reference to the specific clearly defined accounting treatments to be applied in a particular set of accounts is always better than reference to "normal accounting treatments", which are by their nature subjective and open to a degree of ambiguity and possible manipulation by the parties responsible for determining what "normal accounting treatments" means. In addition, it would be inappropriate to

refer to the normal accounting policies of the JV vehicle which as a new entity will not yet be able to identify its “normal accounting treatments”.

- 3.3.9 We note the reference to the role of an independent cost consultant’s review of Bellway costs. It will be important not only to require Bellway to follow good procurement practices designed to deliver value for money but to be clear in the contractual arrangements what sorts of costs they are entitled to recover against the JV and the bases for those costs. Related contractual wording should be clear and unambiguous, particularly in relation to overheads and indirect costs.
- 3.3.10 It is useful to support the detailed contractual wording concerning what Bellway costs may be passed on to the JV with a catch-all clause saying for the avoidance of doubt that no element of profit may be charged by Bellway to the JV (unless there is an agreed cost-plus structure).

Financial outcomes

- 3.3.11 It will be important for the Council to be clear as to the full population of financial variables and elements which it requires to be specified and calculated in a certain way. This analysis should drive the specific clauses in the legal agreements to ensure that costs are calculated and incurred consistently in a prescribed way.
- 3.3.12 It will also be important for the Council to be clear about which relevant financial and other documents it requires access to.
- 3.3.13 We note from the Preferred Bidder Letter dated 19 December 2005 a range of financial provisions which will need to be considered for this purpose. Some of these are:
- Bellway to indemnify the Council against certain costs – these will need clear definition;
 - Bellway to provide some initial funding to the JV – this will lead to the need for clarity over the use of that funding, visibility as to actual and forecast cash flows so that any funding pressures can be seen at an early stage, clarity over how any additional funding is to be sourced and who is to bear the costs, and the terms of repayment of the funding advanced by Bellway;
 - If it is anticipated that additional funding needs could be dealt with by Bellway providing further funding, the terms on which such funding is to be advanced should be agreed;
 - Costs to be incurred by Bellway and recharged to the JV including provisions for competition and market testing – this is a particularly important area and will require careful drafting and review and should include specification of procurement processes to be followed, and careful thought as to the costs expected to be passed on to the JV (this may involve considering inter alia costs incurred versus recovery rates; overheads, indirect costs, deductions for rebates received, etc);
 - Given that the JV’s more substantial outflows will involve payments to Bellway, it will be important from a cash flow perspective to be clear as to the supplier payment terms expected to be applied to such sums;

- Certain costs to be funded by Bellway – again clear definition will be required so that monitoring of the JV’s costs can detect any items of cost wrongly passed through to the JV;
- Guaranteed Minimum Land Values and agreed deductibles and criteria for change – again clear definitions and bases will be needed;
- Profit sharing arrangements - clarity as to the calculation of what is to be included and excluded will be important, as well as the timing of when and how profits are to be paid out by the JV (which in turn will affect the JV’s cash flow needs);
- Costs incurred by one or other party relating to dedicated staff necessary for the operation of the JV - this will need clear definition as such clauses have great scope for disagreement, for example as to those to be included, the definition of dedicated staff (ie how are costs for staff to be dealt with who dedicate only part of their time to the JV), and the costs or rates per hour to be recovered;
- Certain financial risks to be borne by Bellway - it will be necessary to be clear as to definition and process; and
- Certain costs to be reimbursed to the Council during the lifetime of the JV arrangements.

Periodic reporting

- 3.3.14 The Agreement should provide that the JV vehicle maintains proper books of account and makes true and complete entries detailing all its dealings and transactions relating to EASEL.
- 3.3.15 The JV vehicle should provide to the Council regular financial reports, setting out defined information. The minimum content of such reports should be set out in the Agreement. It is risky to leave the content open by using loose phrases like “in such form as reasonably required to be properly informed about the business and affairs of the JV Co.”
- 3.3.16 Advice should be taken prior to signing the Agreement on precisely what information is necessary for the Council to monitor effectively the activities of the JV vehicle. The information provided should go beyond basic summarised accounting information and might include:
- Analysis of variances from budget;
 - Explanation and commentary;
 - Operating statistics and KPIs;
 - Comparable industry data, where appropriate;
 - Cash flow as well as profit and loss and balance sheet information;
 - Revised forecasts regularly updated to reflect the latest actual information; and
 - Supporting analysis to an agreed level of detail.

- 3.3.17 There should be clear timelines for the provision of information. For example, certain standardised information should be provided on, say, a monthly basis.
- 3.3.18 The Agreement should contain provisions relating to the prompt preparation and external audit of the annual accounts. For example, the audit should be completed within say four or at most six months of the year end.

“Open Book accounting”

- 3.3.19 The right of access to information should be clearly defined in the Agreement. We have set out in section 2 a number of practical and commercial considerations relating to “Open Book accounting”. For the purpose of drafting the Agreement, the following should be considered:

- Which information:
- Who has access; and
- What terms of access.

- 3.3.20 The definition of the information to which access should be given should be as broad as the Council can negotiate, including all prime accounting records and supporting information (eg invoices to support costs incurred). It should also be made clear that access should include original electronic records. We have found that without clarity this can sometimes be an area of resistance by the party to be inspected. Similarly, if some of the JV’s accounting records are to be maintained away from the JV’s offices (eg at Bellway’s offices) the rights of access should be designed still to pertain in order for the Council to be satisfied that it has access to all relevant information relating to the JV.

- 3.3.21 The definition of who has access is for the Council to consider. We have discussed above some of the potential advantages of an independent third party having access to information rather than the Council itself. Although there would be an associated cost to the Council, if it emerges that Bellway is more accepting of an independent third party than of the Council having its own access rights, then a judgement may have to be reached as to whether it is better to have a constructive process via a third party than a potentially confrontational process which could impact the ongoing working relations.

- 3.3.22 It is worth noting that it is often possible to structure an independent third party review so as to share or pass on the costs depending on the findings (ie, if misreporting is identified above a defined tolerance, then Bellway pay some or all of the costs). It is relatively common in our experience to build in provisions which would permit the party wishing to have access to have the right to appoint agents to act on their behalf who would for this purpose have the same access rights as the Council.

- 3.3.23 The definition of the terms of access relates to both the frequency with which the Council may have formal access to books and records and the practical considerations of exercising the right to access. The right to conduct an annual review would be a minimum (and as noted in section 2 above the right ought to be exercised in a routine way). It is generally more helpful to have a provision permitting access on the giving of an agreed notice period (eg two working days) and not constraining the frequency of

access so that the Council has the option to elect for access when it feels it needs it (though note in this context our earlier point that maintaining a degree of *regularity* about the exercise of the access provisions in practice generally makes it more of routinely accepted activity). We have had situations where apparently innocuous contractual terms such as the right to access information “during normal business hours” have been used to make life difficult for the party attempting to review information. It is also important to have the right to take copies of information which may be required in order to challenge the other party on the accuracy of its record-keeping. Some thought will need to be given to how this would apply to electronic information, which is often critical.

3.4 Iterative process at key milestones

- 3.4.1 As well as the above ongoing process of monitoring and checking the financial results of the JV vehicle, the Council should have specific procedures in place relating to key milestones in the development process.
- 3.4.2 At the beginning of each phase the Council should have a right of veto over proposed development activity. Paragraph 6.5 of the Preferred bidder letter from the Council to Bellway dated 19 December 2005, quoted at paragraph 1.1.5 above, refers in this context to the use of an independent cost consultant.
- 3.4.3 At the end of each phase, the final financial results for that phase will feed through into income for the Council and although the monitoring and review processes recommended in this report should assist in promoting the completeness and accuracy of such reports there does need to be specific provision for challenging the detail of the reports.
- 3.4.4 In both these contexts, we have experience of appropriate structures and processes for prior agreement of each phase of development and for determining the final financial results of each phase.
- 3.4.5 At the beginning of a phase, an appropriate procedure may operate as follows:
- The developer produces a financial appraisal of the phase, including a budget and viability study, which are submitted to the Council;
 - The Council then has the right to raise objections and to suggest amendments, which would normally involve the Council’s independent cost consultant; and
 - In the event that objections or proposed amendments cannot be agreed by the parties, there should be provision for independent determination of the final financial appraisal by an appropriately qualified independent expert.
- 3.4.6 At the end of a phase, an agreed statement of the relevant income and costs would be provided in draft and the Council would have the right to review it and raise objections within a defined period. If objections are raised by the Council and cannot be resolved by negotiation, then there should be a dispute resolution process, typically involving independent expert determination.

3.5 Other general issues

Dispute resolution

- 3.5.1 A more general dispute resolution process should be included in the Agreement, usually involving escalation from formal discussion by the parties to a form of mediation, which is a further method of achieving a negotiated settlement, then finally a process whereby the parties hand the issue on to someone to decide for them. This could be independent determination, litigation or arbitration. Furthermore, under Construction law either party could opt for a binding Adjudication (this being a very quick process taking 28 to 42 days) at any time, whatever the Agreement says.
- 3.5.2 As regards the other methods mentioned, independent determination and arbitration have some advantages – principally privacy nowadays, as litigation can in fact be quicker than arbitration as there is less full-blown litigation about now and the Courts can move matters along faster than a busy Arbitrator might.
- 3.5.3 The precise wording of the dispute resolution process is of course a legal issue.

Annual progress review

- 3.5.4 We commented in paragraph 3.3.3 that an annual review process may be useful. An agreement we have seen recently envisaged such a process “with the sole purpose of providing the Parties with an opportunity to discuss lessons learned and to improve the Parties’ ability to forecast spend.”
- 3.5.5 This could be regarded as part of the ongoing dialogue which we see as critical in handling successfully the kind of JV arrangement being considered by the Council.

Contract Management

- 3.5.6 We recognise that the Council is currently in the design stage for arrangements to manage the contract as negotiations are ongoing. Our experience from similar schemes elsewhere demonstrates the importance of thinking about who will be involved in ongoing contract management at an early stage. Contract administration and management usually passes to the Client Directorate after the signing of contracts. Our view is that there should be an involvement in the commercial negotiation from someone who will have an ongoing role in managing the contract to ensure that operational management maximises the commercial value for the council obtained at the negotiation stage. A robust performance management system should be determined around the key personnel whilst still in the design phase.

4 Conclusion

- 4.1.1 It is critical that the Council actively manages its risk through the Agreement and also once the JV vehicle is in place.
- 4.1.2 The legal arrangements provide a once only opportunity to set a robust framework for the ongoing detailed risk management activity and set the rules which will govern the activities and reporting arrangements.
- 4.1.3 Active management of risks by regular and indeed routine engagement with the activities and reported results of the JV vehicle and a more effective control over its activities are, in our experience, more likely to promote better working relationships between the JV partners than to damage them.
- 4.1.4 We intend to consider the ongoing development of the EASEL project as part of our external audit planning and will consider the extent to which KPMG's experience may be relevant to the City Council as the JV arrangements are developed and formalised, and as it begins to operate and report.