Government Internal Audit Agency

Department for Transport

HS2 Ltd Redundancy Schemes

Management letter

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Distribution of Report

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INTRODUCTION

HS2 Ltd operates under a Framework Document which the Department is responsible for setting. This document is signed by both the Department and the Company and states that the Company requires Departmental permission to vary any redundancy scheme from statutory terms. HS2 Ltd ran a redundancy scheme using civil service terms rather than statutory terms. These are known as 'enhanced' terms[1].

This scheme involved both compulsory and voluntary redundancies and arose from a restructure of the business, a relocation of the main offices from London to Birmingham and the closure of a very small call centre.

In his opinion on the 2016/17 Report and Accounts for HS2 Ltd, the Comptroller and Auditor General at the NAO offered a qualified regularity opinion, judging that the committed expenditure on the redundancies of £2.76m was £1.76m in excess of the amounts that would have been payable had statutory levels of redundancy been paid. These excess payments were, because they were not authorised, irregular expenditure.

LIMITATION OF SCOPE

No work has been undertaken to assess the completeness of the total value of payments made, relying instead on the NAO's published opinion. Nor have we recalculated any individual payments to test for accuracy or the eligibility of any individuals per the scheme rules. HS2 Ltd has not made available any personally identifiable information to the audit team, which has meant that we have been unable to robustly test the authorisation of these payments or for any conflict of interest, but this has not had a material impact on the conclusions we have drawn.

We have not made contact with any individual who is either no longer engaged by HS2 Ltd or who is no longer a civil servant, but we note that there has been significant turnover of staff, especially at HS2 Ltd, involved in operating or supervising the redundancy scheme. It has not always, therefore, been possible to establish a sequence of events or the rationale for decisions made where this has not been clearly recorded.

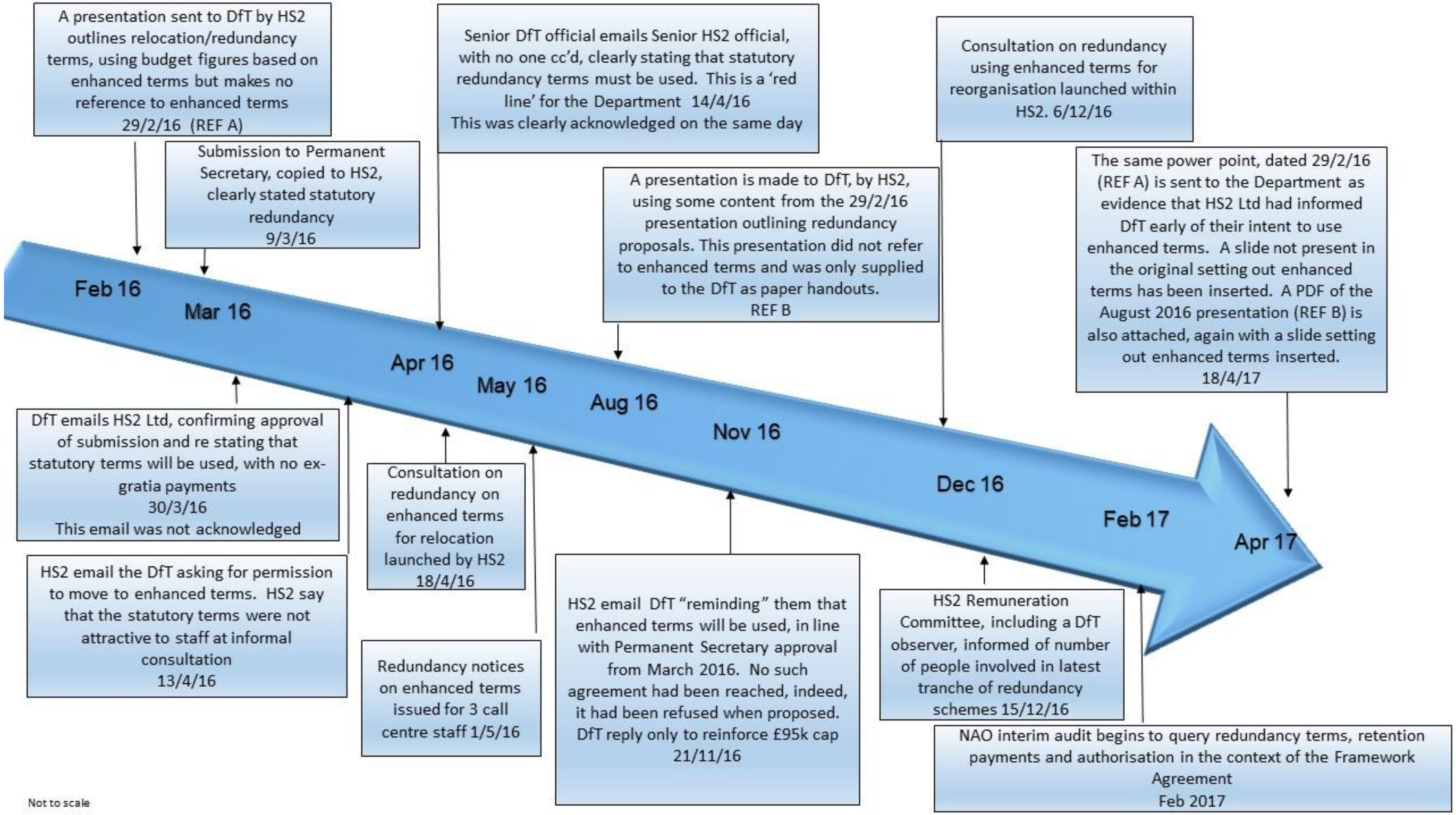
BACKGROUND

This review was commissioned by the DfT Permanent Secretary following the qualification of the HS2 Ltd accounts. It was commissioned to identify lessons that can be learned and changes that will help to improve practice at both the Department and HS2 Ltd.

TIMELINE

To aid readers in understanding the sequence of events, a timeline of key events and documents is presented here. This should be read in conjunction with the rest of this report and not presented in isolation.

[1] HS2 Ltd used 1 month pay per year of service. In November 2016, the Government reduced the civil service terms to 3 weeks pay per year. Subsequently, this has been subject to successful legal challenge. For the purposes of this report, therefore, we define 'enhanced' terms as offering 1 month pay per year of service, as opposed to statutory terms. These vary by age but are best approximated to one week's pay for each year of service with a minimum of 2 year's service required.


A presentation sent to DfT by HS2 outlines relocation/redundancy terms, using budget figures based on enhanced terms but makes no reference to enhanced terms 29/2/16 (REF A)
Submission to Permanent Secretary, copied to HS2, clearly stated statutory redundancy 9/3/16
Senior DfT official emails Senior HS2 official, with no one cc'd, clearly stating that statutory redundancy terms must be used. This is a 'red line' for the Department 14/4/16
This was clearly acknowledged on the same day
A presentation is made to DfT, by HS2, using some content from the 29/2/16 presentation outlining redundancy proposals. This presentation did not refer to enhanced terms and was only supplied to the DfT as paper handouts.
REF B
Consultation on redundancy using enhanced terms for reorganisation launched within HS2. 6/12/16
The same power point, dated 29/2/16 (REF A) is sent to the Department as evidence that HS2 Ltd had informed DfT early of their intent to use enhanced terms. A slide not present in the original setting out enhanced terms has been inserted. A PDF of the August 2016 presentation (REF B) is also attached, again with a slide setting out enhanced terms inserted.
18/4/17
Feb 16
Mar 16
Apr 16
May 16
Aug 16
Nov 16
Dec 16
Feb 17
Apr 17
DfT emails HS2 Ltd, confirming approval of submission and re stating that statutory terms will be used, with no ex-gratia payments
30/3/16
This email was not acknowledged
HS2 email the DfT asking for permission to move to enhanced terms. HS2 say that the statutory terms were not attractive to staff at informal consultation
13/4/16
Consultation on redundancy on enhanced terms for relocation launched by HS2
18/4/16
Redundancy notices on enhanced terms issued for 3 call centre staff 1/5/16
HS2 email DfT "reminding" them that enhanced terms will be used, in line with Permanent Secretary approval from March 2016. No such agreement had been reached, indeed, it had been refused when proposed. DfT reply only to reinforce £95k cap
21/11/16
HS2 Remuneration Committee, including a DfT observer, informed of number of people involved in latest tranche of redundancy schemes 15/12/16
NAO interim audit begins to query redundancy terms, retention payments and authorisation in the context of the Framework Agreement
Feb 2017
Not to scale

EXECUTIVE SUMMARY

1. This audit has established both primary causes and other contributory factors that resulted in the running of an irregular redundancy scheme at HS2 Ltd. It has also sought to explore the governance arrangements at both HS2 Ltd and the Department, and make recommendations aimed at preventing a recurrence of this issue both at HS2 Ltd and at other ALBs.

2. This report is presented as a management letter as the irregularity of the redundancy scheme has been established by the NAO. This report is therefore designed to explore the reasons why the scheme was able to proceed and to make related recommendations, rather than offering an historic audit opinion.

3. Fundamentally, the redundancy scheme was only able to proceed because of the primary cause. Nevertheless, the other contributory factors are important; were the governance arrangements stronger, particularly but not exclusively at HS2 Ltd, then it is likely that the scheme would have been questioned and potentially stopped.

4. In addition, during the course of the audit we found that some information shared with the Department and the NAO had been altered within HS2 Ltd to suggest earlier disclosure of the enhanced terms than had in fact occurred. It is important to note however that this was not a material contributory factor to the establishment of the irregular schemes.

Primary Cause

- HS2 Limited introduced an enhanced redundancy package which was prohibited by their Framework Document. HS2 Ltd did this even after the Department had instructed it not to. A senior official at HS2 Ltd acknowledged this instruction, yet the enhanced scheme proceeded.

Contributory Causes

- The governance bodies at HS2 Ltd, were not sufficiently briefed, knowledgeable or effective enough to identify that an irregular scheme was being introduced. Effective and appropriate governance structures, rooted in the Framework Document, could have prevented this scheme from proceeding. The Framework Document makes it clear that it is the responsibility of the HS2 Accounting Officer to establish such governance arrangements, but also gives the Department a responsibility for ensuring that HS2 Ltd has done so.

- HS2 Ltd did not demonstrate a good appreciation of their position in the Departmental group, where direct permission would be required to deviate from the terms of the Framework Document. We note that a new sponsorship director has been appointed at HS2 Ltd with the aim of improving this situation. HS2 staff are all to be given a re-induction between November 2017 and March 2018 to ensure that all staff are aware of the requirements of Managing Public Money, in both letter and spirit, and the key governance documents between DfT and HS2 Ltd (Development Agreement and Framework Document).

- The Framework Document between HS2 Limited and DfT was not well understood and is due for revision. HS2 Ltd gave significantly more attention to the provisions of the Development Agreement than the Framework Document.

- There were missed opportunities for the Department to intervene to stop the schemes; though these opportunities were blunted by HS2's assertion that permission had been granted for the enhanced schemes, and by staff consultations launched as early as April 2016 using enhanced terms.

- Staff turnover at both organisations, and a reliance on interims at HS2 Ltd, created gaps in knowledge and continuity that gave rise to opportunities to stop the irregular schemes being missed through inexperience. Gaps between key posts being filled and a lack of effective handover, together with a tendency towards informal decision making and a lack of effective record keeping, exacerbated this problem.

- The relationship between the Department and HS2 Ltd was not developed enough to facilitate clear and appropriate communication. Key decisions and advice was sent by email which often went unacknowledged by the other party. The sender routinely took this lack of response as agreement, sometimes following a verbal update. Neither organisation has demonstrated effective record keeping of key decisions in this process, often reliant on emails held in personal inboxes.

- The Department lacked, and to an extent lacks, clear guidance and training for the HS2 shareholder team to help them to discharge their important role. The relationship between shareholder teams and professional teams, such as finance and HR, within the DfT is ill-defined and requires development.

- The operational controls at HS2 Ltd were insufficient to enforce compliance with delegations, authorisation of payments and segregation of duties. This has resulted in some payment errors being made and reclaimed. We have not been able to test the operation of these controls in the period in question because the design of the controls was not documented.

Summary of Recommendations made

5. This audit has made nine recommendations to the Department and to HS2 Ltd. The Department and HS2 Ltd, working together at Accounting Officer level, have adopted an action plan to address all of these recommendations.

Recommendation one – *HS2 Ltd should ensure that its current records management process represents best practice and that minutes, in sufficient detail to clearly record* *decisions made, are retained. To ensure there is confidence in this system, which we understand HS2 Ltd have already developed, it should be independently audited or assessed.*

Recommendation two – *HS2 Ltd, working closely with the shareholder team in the DfT, should ensure that a greater consciousness is developed within the Company of the need to work within the letter and spirit of documents like Managing Public Money. This will give an opportunity to enhance day to day governance. We note that HS2 Ltd are overhauling their induction process and planning to 're-induct' all employees – this material should be developed in close conjunction with the DfT shareholder team to ensure this opportunity is exploited to its maximal extent. The re-induction process is due to complete by March 2018; consideration should be given to accelerating the completion of this if possible.*

Recommendation three – *HS2 Ltd and the Department should consider the terms of reference for their shareholder governance bodies, including the Remuneration Committee, in the light of these events, and update them, making clear the role of all members on these bodies.*

Recommendation four – *The Department and HS2 Ltd should identify clear and expected protocols for communication and agreement within the shareholding relationship. These should remain efficient and not be over bureaucratic but should support clear and robust decision making.*

Recommendation five – *The Department and HS2 Ltd should revise the Framework Document to remove any scope for misunderstanding, and to ensure that it is an up to date document positioned to support a growing company in the delivery of a complex construction project. Both HS2 Ltd and the Department should ensure that relevant staff are aware of the provisions of the agreement. Once this has been revised, HS2 Ltd should revise and formally reconfirm its policies, for example but not exclusively for redundancy, to ensure they make clear and accurate reference to the Framework Document.*

Recommendation six – *The Department should, following this incident, take the opportunity to overhaul and bolster the shareholder function to a greater extent than has been possible to date, including consideration as to how the DfT professional functions and the shareholder teams interact.*

Recommendation seven – *The Department should, in part through the new controls working group, ensure that there is appropriate knowledge of broader government controls and that avenues of obtaining expert support are clearly defined. The Department should review the level of support that its group professional functions provide to arms length bodies, particularly over complex HR issues like pay.*

Recommendation eight - *HS2 Ltd should consider the robustness of their self assessment process for the 2018 Management Assurance return.*

Recommendation nine – *As part of an ongoing approach to updating controls, HS2 Ltd should ensure that effective and appropriate controls, which enforce senior sign off and segregation of duties, are applied. The Department should consider how it assures itself that appropriate controls are in place within the Company.*

EXPLANATION OF KEY FINDINGS AND RISKS

What were the redundancy programme's governance arrangements, how were these designed and communicated, and how did these governance arrangements align with expected practice for agreeing and administering redundancy schemes in the public sector?

6. At HS2 Ltd a working group called the 'Developing Our Company Panel' was responsible for overseeing the development of a changed organisational structure and implementing it. Developing Our Company was chaired by the Chief Financial Officer and relevant and senior officials sat on it. As far as we can tell from the action point focussed minutes, there was relatively little discussion of the redundancy programme itself. The Company has explained this as being a sign that the redundancy programme was not an output in its own right, but a consequence of the business decision to restructure.

7. The associated relocation to Birmingham, and the redundancies, were overseen by the People Panel, which became the Management Panel; both of which no longer exist. Any deviations from the expected payments were to be agreed by the Exceptions Panel. We have explored these panels in the section below on day to day governance.

8. We have obtained a voluntary redundancy policy from the company but no minutes exist to demonstrate where this policy was approved – we believe by now defunct management panels. This policy does not detail how amounts of redundancy should be calculated, but does require the creation of an Exceptions Panel to consider individual cases where necessary. No minutes have been found for the exceptions panel so we cannot confirm whether it met to consider any of the individuals highlighted by the NAO as being paid in excess of £95k by the NAO's definitions. We note that HS2 Ltd state they have updated their records management process since this period and have involved their bolstered company secretariat function in minute taking.

9. Typically, within the public sector there would be more active governance of the redundancy scheme itself. In essence we have been unable to identify how the day to day running of the scheme was directed, other than under the control of individual members of staff. We make further observations regarding the controls in place around the operation of the scheme below.

10. We note that HS2 Ltd has subsequently overhauled its governance arrangements that apply to HR, though we have not tested these as part of this work as they fall outside of our scope.

Recommendation one – *HS2 Ltd should ensure that its current records management process represents best practice, and that minutes, in sufficient detail to clearly record decisions made, are retained. To ensure there is confidence in this system, which we understand HS2 Ltd have already developed, it should be independently audited or assessed.*

Recommendation two – *HS2 Ltd, working closely with the shareholder team in the DfT, should ensure that a greater consciousness is developed within the Company of the need to work within the letter and spirit of documents like Managing Public Money. This will give an opportunity to enhance day to day governance. We note that HS2 Ltd are overhauling their induction process and planning to 're-induct' all employees – this material should be developed in close conjunction with the DfT shareholder team to ensure this opportunity is exploited to its maximal extent. The re-induction process is due to complete by March 2018; consideration should be given to accelerating the completion of this if possible.*

What were the redundancy programme's approval route(s), and which governance forums - both within HS2 Ltd and DfT - played a role in commissioning, implementing and monitoring the programme? To include formal governance arrangements at both HS2 Ltd and the Department; for example the remuneration committee of HS2 Ltd and the High Speed Rail Group (HSRG) Board.

11. Effective governance at an arm's length body relies on all parties having clearly defined roles and responsibilities and discharging those responsibilities. Within the DfT group different entities operate at different levels of 'arm's length' depending on the nature of the body, but all share the common position that the arm's length body is responsible for making appropriately authorised decisions; with the Department interested in whether governance processes are in place to facilitate these decisions.

12. The redundancy programme was a consequence of business decisions at HS2 Ltd to relocate the headquarters to Birmingham as well as the change in focus of the company after the Hybrid Bill work was completed. A small call centre was also closed. These generated compulsory redundancies. In addition, a voluntary redundancy programme was established resulting from additional corporate restructuring at the same time. These were operational business decisions that were taken appropriately by the HS2 Ltd executive committees and Board.

13. The decision to run these schemes was made by a now defunct People Panel, a sub-committee of the Executive, but minutes do not survive for this panel. This is in contrast to normal public sector practice where the commissioning of a redundancy scheme is normally seen as a significant decision in itself; and where the eligibility for and design of the scheme would almost certainly be approved by the most senior leadership board or executive in the organisation. We note that the HS2 Ltd Board requested an update on the progress of the scheme from May 2016 onwards in the 'CEO update' paper to the board, but this was only provided once in this paper or its equivalent between June 2016 and March 2017 by both the previous and interim CEO, though some other less formal ad hoc updates were provided.

14. The discussion of this scheme was within the remit of the People Panel but it did not then follow its terms of reference, "To document, manage and mitigate/action to HS2 Ltd staff, escalating appropriately to the Management Committee or Remuneration Committee" where it might be expected that a large scale redundancy programme would have been escalated for decision making. However, the approval of a redundancy scheme is not itself within the terms of reference of the Remuneration Committee. Without minutes of this panel it is difficult to confirm this and we do note that, subsequently, HS2 Ltd have

overhauled their structures and involved their bolstered company secretariat in minute taking and paper retention.

15. The HS2 Ltd Remuneration Committee met regularly throughout the period. The terms of reference of the Remuneration Committee do not explicitly refer to redundancy schemes. The committee had discussed the relocation project in June 2016, but agreed that supervising such a scheme was outside of their terms of reference. In addition, redundancy notices on enhanced terms had already been issued to 3 call centre staff on 1 May 2016 and a staff consultation regarding relocation with enhanced redundancy was launched on 18 April 2016. A more effective Remuneration Committee, appropriately consulted with during the development of such a scheme or constituted to supervise it, may have been able to prevent an irregular scheme being introduced. It would be speculative to suggest that had the terms been discussed, the DfT observer would have identified the issue, but this would have increased the prominence of the variation in terms and made it much more likely that this could have been questioned.

16. We note that HS2 Ltd have, subsequently used their expanded company secretariat function to overhaul governance arrangements.

17. Within the DfT, we have not identified any evidence to suggest that the redundancy scheme was discussed at a governance group until the NAO audit. The HSR group programme board was clearly more programme centred in this period and it did not discuss issues relating to 'shareholding', creating a gap in the governance structures. In the Spring of 2017 a Shareholder Meeting was set up within HSR group to consider non-programme issues and this meeting, had it been in existence, probably would have discussed the programme. It would be speculative to suggest that this more formal shareholder governance within the DfT would have been able to prevent the unauthorised scheme; but a formal meeting to identify what communications had taken place, and what risks existed around a scheme, might have increased the prominence of the risks before they crystalised and, at the very least, would have broadened awareness of the issues. This may also have mitigated some of the risks of staff turnover and corporate memory highlighted elsewhere in this report. For example, a set of minutes from a Shareholder Meeting would have created a clear and available record which would have been available to more officials and so may have prompted more questioning when HS2's intent to proceed with the scheme became more widely known. We make recommendations below regarding the structure of shareholding functions within the Department which may further address this risk.

18. The Redundancy scheme appears to have been first raised with the Department in February 2016. A presentation dated 29/2/16 was sent to the Department entitled 'HS2 Ltd Relocation Support Proposal'. This did not contain reference to enhanced terms. During March there was considerable discussion between the Department and HS2 Ltd, including consultation with the Permanent Secretary. Most of this was verbal. This resulted in a formal submission to the Permanent Secretary on 9/3/16 which was copied to HS2 Ltd and stated:

    "HS2 Ltd currently operate a Statutory Redundancy policy. This will be applied in circumstances where employees opt to leave the Company, rather than relocate. Implementation of the redundancy scheme will require Cabinet Office sign-off, in line with their controls guidance, which will be facilitated by DfT HR."

19. There could be scope for ambiguity in this paragraph as to whether HS2 Ltd or DfT HR should take the lead with obtaining Cabinet Office approval for the scheme, but that HS2 Ltd, at a senior level, were aware that the scheme was only approved on statutory terms and that Cabinet Office involvement was required, is beyond doubt. Managing Public Money also makes it clear that it is the Accounting Officer at the entity concerned who is responsible for adherence with Treasury controls.[2] We further note that, in spite of this clear paragraph within the submission, the figures HS2 Ltd presented at the time to accompany the submission were, apparently (though we have not attempted to recalculate these) on the basis of enhanced terms. This was not explicitly signalled to the DfT. We also note that, while these costs were identified in papers discussed at the HS2 Ltd board, there was no specific business case for the redundancy programme itself at HS2 Ltd.

20. Following further discussion within and between both organisations, an email was sent from the DfT to HS2 Ltd on 30/3/16 approving the scheme; again with a direct instruction that any variation from statutory terms required further permission from the Department.

21. We have an email record that, on 13/4/16, HS2 Ltd requested permission to run an enhanced scheme as they believed the statutory scheme was unattractive to employees. On 14/4/16 there was a direct email from a senior official in the Department to a very senior official at HS2 Ltd, which was acknowledged and accepted on the same day, that any scheme must be statutory – this was a “red line” for the Department. There is no evidence that this instruction was disseminated further within HS2 Ltd, creating a ‘single point of failure’. This was identified by the NAO in their qualified audit opinion. A more formal communication or governance structure might have ensured that more people knew of this instruction at the time. We commissioned further IT testing by HS2 Ltd on their systems and they have confirmed that they cannot identify any evidence of an emailed instruction being passed on within the company.

22. Immediately following this email exchange, on 18 April 2016, a consultation was issued relating to the relocation from London to Birmingham. This included enhanced redundancy terms for impacted staff. Similarly on 1 May 2016 redundancy notices, again on enhanced terms, were issued to 3 call centre staff. We understand that the issue of such consultations may have created a legal obligation to use these terms.

23. A presentation was created by HS2 Ltd, dated 29/2/16, setting out key aspects of the relocation scheme proposed, including the associated redundancies. This presentation made no reference to enhanced redundancy terms and we have obtained a contemporaneous electronic copy which we have verified. However, a presentation with the same title, content and 29/2/16 date was sent to the NAO in February 2017 by HS2 Ltd, and forwarded to the Department in April 2017, with an additional slide illustrating enhanced redundancy terms inserted. We conclude that this powerpoint was amended between February 2016 and February 2017. The limited evidence indicates the presentation was amended by someone at HS2 Ltd, and HS2 Ltd have confirmed this. There is no clear evidence to explain why, or exactly when, this presentation was amended.

[2] Managing Public Money, Chapter 3, specifically paragraph 3.3.3

24. There is no evidence of any written communication between HS2 Ltd and the Department from 14 April 2016 until November 2016 relating to the scheme. We do know that a presentation was given by HS2 Ltd to the Department in August 2016 that provided an update on the relocation and redundancies. DfT officials, most of whom are no longer in post, have no recollection of this presentation containing enhanced terms in August 2016 and the presentation was not sent to the Department at the time. The presentation was only sent to the Department in April 2017.

25. We therefore asked HS2 Ltd to further investigate this presentation, in the light of our evidence relating to the February 2016 document narrated above. HS2 Ltd have confirmed that this presentation was also edited and the slides used at August 2016 did not refer to enhanced terms but the version sent in April 2017 did. We therefore conclude that this presentation was also altered in this timeframe by someone at HS2 Ltd, but we cannot evidence when. In any event, given the formality of the March 2016 Permanent Secretary Submission it is not likely that an un-minuted and informal presentation would represent an approval mechanism for a fundamental change to the basis of the scheme. On 21 November 2016, HS2 Ltd emailed the Department stating:

   "*As a reminder, the provisions allow payment of one month per completed year of service, provided the employee has served one complete year of continuous service. We are aware of a 'cap' on redundancy payments of £95,000 and we confirm that this will not be breached*."

26. This email stated that this was in line with the business case approved by the Permanent Secretary in March 2016, a statement now known to be untrue – the approval by the Permanent Secretary was for statutory terms only, as quoted above. We have not been able to ascertain why this statement was written by HS2 Ltd.

27. As mentioned in paragraph 15, in the 15 December 2016 meeting the Remuneration Committee were informed of the number of proposed redundancies in a dashboard that was submitted to the meeting. In advance of this meeting a briefing was given to the Departmental observer on the committee by the HSRG shareholder team that outlined the terms of the scheme relating to restructuring which ultimately were shown to be enhanced. There was no mention, from DfT officials, of the irregularity of the proposals at this stage because they were unaware that this was the case – the briefing given was informed by correspondence from HS2 Ltd in November 2016 to the Department which (incorrectly) stated the scheme was in line with the Permanent Secretary's prior approval and therefore there was no assumption made that the terms were enhanced. Furthermore an internal briefing document had been circulated to staff at HS2 Ltd on 6th December 2016, effectively committing the company to the enhanced terms for this tranche of redundancies.

28. While there were 3 schemes in operation, relating to the call centre, relocation and restructuring it appears that a decision was made within HS2 Ltd to pay enhanced terms for redundancies before 18 April 2016, contrary to the email from the Department on 14 April 2016. We have been unable to find any evidence of when, why or by whom this decision was made. We have been unable to corroborate HS2 Ltd assertions that they believed they had received permission from the Department or what gave rise to this belief. Subsequently, a consultation was also launched in December 2016 relating to the restructuring that also used enhanced terms.

29. In this chain above, we can identify a number of opportunities to stop the schemes from proceeding and contributory factors to this not occurring. However, we have been unable to identify precisely when, why or by whom, the decision was made to pay enhanced terms against the clear instruction of the Department.

    Recommendation three – *HS2 Ltd and the Department should consider the terms of reference for their shareholder governance bodies, including the Remuneration Committee, in the light of these events, and update them, making clear the role of all members on these bodies.*

    Recommendation four – *The Department and HS2 Ltd should identify clear and expected protocols for communication and agreement within the shareholding relationship. These should remain efficient and not be over bureaucratic but should support clear and robust decision making.*

    Recommendation five – *The Department and HS2 Ltd should revise the Framework Document to remove any scope for misunderstanding, and to ensure that it is an up to date document positioned to support a growing company in the delivery of a complex construction project. Both HS2 Ltd and the Department should ensure that relevant staff are aware of the provisions of the agreement. Once this has been revised, HS2 Ltd should revise and formally reconfirm its policies; for example, but not exclusively, for redundancy, to ensure they make clear and accurate reference to the Framework Document.*

How did the different constituent parts of the HS2 programme communicate and share information about the redundancy programme in a way that facilitated open, transparent and collaborative behaviours? How did HRSG and other parts of DfT (finance, HR, legal) work together to provide a joined up view of the programme?

30. Within HS2 Ltd, the majority of staff closely involved with the redundancy programme have left. In part this is natural turnover of individuals, particularly as a company changes purpose significantly from being focussed on obtaining powers to build, to a construction management company. However, it also demonstrates a significant reliance on interim staff at HS2 Ltd, which does not help to generate a good corporate memory or behaviours that are always aligned to the long term interests of the company.

31. During the course of this audit we have identified that an email was created by an official at HS2 Ltd that, had it been sent when it purported to have been sent, would have shown earlier communication of the full extent of the redundancy scheme to the Department in the Spring of 2017. Interrogation of IT servers has demonstrated that this email was not sent but it appears to have been created to demonstrate earlier communication. Why this was done is unclear, but this was clearly too late to have prevented the scheme and the individual involved has left the company. In our judgement, while a concerning fact, this is not material to the outcome, in that an irregular scheme was committed to and underway by this date.

32. There is clear evidence of a culture of informality, at all levels, where emails were sent to outline a position and not responded to, with the sender taking this as assent, probably, but not verifiably, backed up by a telephone conversation. This lack of formality may have helped foster working relationships and in some ways can be seen as efficient, but it was not the basis for a robust shareholder/company relationship.

33. The evidence supplied to us demonstrates that a variety of individuals were in correspondence between the Department and HS2 Ltd over the redundancy scheme. At the Department these included people in the shareholder team at HSRG, but also officials in HR and Group Finance, though the latter only as the NAO's audit unfolded. There does not appear to have been a consistent practice in dealing with this correspondence; Departmental specialists in finance and HR sometimes, but not always, included the shareholder team in correspondence. It is unclear what capacity departmental specialists, in particular in HR, were being consulted in and what the scope of their advice was, or whether knowledge of the exact statutory and Framework Document constitution of HS2 Ltd was being assumed.

34. This lack of clarity had an impact on this situation when, in November 2016, HS2 Ltd approached DfT HR directly, asking for clarification on the £95k ceiling for payments. This was sent within two days of an email from HS2 Ltd which they erroneously stated that the payment of enhanced terms had been approved in March 2016 by the Permanent Secretary and that HS2 Ltd understood the £95k cap. DfT HR responded only to the question asked about the £95k, but a wider appreciation of the Framework Document, more formal consultation between shareholder and professional functions or more specialist resource in the professional functions might have resulted in this enhanced scheme being questioned at this stage. Similarly, when in December 2016 a new member of the shareholder team briefed the DfT observer in advance of attending the forthcoming Remuneration Committee they highlighted the detail of the redundancy scheme described in the e mail from HS2 Ltd to the Department which stated (incorrectly) the scheme was in line with the Permanent Secretary's prior approval. A better corporate memory might have allowed the key information that this was not authorised to be shared. – but the clear statement from HS2 Ltd that the scheme had been approved might have negated even this hypothetical intervention.

35. There is a lack of knowledge of the interaction between the Framework Document and both Cabinet Office and Treasury Controls demonstrated by these missed opportunities. Further, as the NAO audit progressed, there is evidence of some confusion between officials relating to which Treasury or Cabinet Office controls were relevant. While this is an exceedingly complex area, and the Department is taking positive action by setting up a controls working group in August 2017, there is a need to bolster working knowledge of these controls and how they apply across the group, within the DfT professional functions.

36. At both HS2 Ltd and at the Department, there was a lack of understanding of the contents of, or the importance of, the Framework Document with HS2 Ltd, and the agreement itself requires clarification. It is an important contract between the Department and the Company but most interviewees during this audit concede that they had not read the document before the NAO audit. It is clear that there was not widespread knowledge of detailed provisions that trade pay flexibility in exchange for a clear requirement to pay statutory redundancy. The Framework Document actually states:

"Any proposal by HS2 Ltd to…pay any redundancy or compensation for loss of office above statutory requirements…requires the prior approval of the Department".

37. While this Framework Document makes very clear the absolute responsibility of the HS2 Ltd Accounting Officer for governance and control, it also gives a responsibility to the Department, via the Permanent Secretary and Senior Sponsor, to assure themselves that such arrangements are in place.

38. Interview evidence has consistently indicated that the role of the shareholder team was not widely understood in this period, still less the interaction between the responsibilities of the Shareholder and the DfT professional teams in, for example, HR. This weakness in the Department's arrangements was highlighted in an internal audit report in 2015/16[3] which resulted in a new approach to 'Delivery Body Partnership' which has been developed subsequently but, as at 1 September 2017, was not yet agreed in final. We do note that the discussion and engagement around developing this approach in consultation with shareholder teams has had a positive impact in its own right.

The Cabinet Office[4] state:

"Partnerships work well when relationships between departments and arm's-length bodies are open, honest, constructive and based on trust. There is mutual understanding about each other's objectives and clear expectations about the terms of engagement".

Recommendation six – *The Department should, following this incident, take the opportunity to overhaul and bolster the shareholder function to a greater extent than has been possible to date, including consideration as to how the DfT professional functions and the shareholder teams interact.*

Recommendation seven – *The Department should, in part through the new controls working group, ensure that there is appropriate knowledge of broader government controls and that avenues of obtaining expert support are clearly defined. The Department should review the level of support that its group professional functions provide to arms length bodies, particularly over complex HR issues like pay.*

How did HS2 Ltd assess the risks to the redundancy programme, and how was this understanding shared with others?

39. The key risk that was not addressed as part of this programme was that of irregularity and government controls. HS2 Ltd was very alive to business risks and programme risks resulting from the relocation programme which, it must be remembered, drove the redundancy programme. It has been stated in interview during this audit that there is a

[3] GIAA 'Department for Transport Governance of ALBs', 16 March 2016, Limited opinion report
[4] Cabinet Office, 'Partnerships between departments and arm's length bodies; Code of Good Practice'

perception that HS2 Ltd are concerned primarily with programme delivery and certainly these risks were clearly considered during the relocation and redundancy process. There was a risk of loss of skills and knowledge, excessive reliance on contractors and programme delay, all of which HS2 Ltd sought to mitigate.

40. Unfortunately, in the context of public sector governance, in their efforts to retain staff HS2 Ltd did not have a process in place to support compliance with government controls and the terms of the Framework Document. Ultimately, HS2 Ltd has established itself with a headquarters in Birmingham and key business objectives, like the passing of the Hybrid Bill and the letting of Civil Works contracts, have been achieved. This is probably further evidence of good programme controls but less developed organisational controls being in place. Subsequently, we have been provided with all staff communications from the CEO of HS2 Ltd stressing the importance of operating properly in a public sector framework and demonstrating this.

Recommendation – *Please see recommendation two.*

What controls did HS2 Ltd put in place to mitigate the redundancy programme's risks?

41. We note that the HS2 Ltd Management Assurance response, regarding compliance with and understanding of Cabinet Office and HMT controls was self assessed as 'green' in 2016 and at period 9 in 2017, only being downgraded after the NAO audit work uncovered issues with the redundancy scheme. We have otherwise considered this scope area below.

Recommendation eight - *HS2 Ltd should consider the robustness of their self assessment process for the 2018 Management Assurance return.*

How did HS2 Ltd ensure the redundancy programme was administered effectively, and not open to misuse, fraud or error?

42. We proposed testing the segregation of duties surrounding actual payments but have been unable to efficiently do so without access to personal data – for example redundancy notifications/authorisations. We have been made aware of a small number of payment errors which occurred after the 31st March year end which was tested up to by the NAO, but we have not performed further work in this area. These errors included, we are told, payments made to persons who were no longer eligible to receive them, because they had been redeployed and so were no longer in scope for redundancy. We are told these payments have been recovered in full.

43. What we do observe, is that the segregation of duty and delegation of responsibility for authorising and paying redundancies was not documented. We cannot therefore confirm, because key individuals involved have left, whether this was implemented or not. That there were, apparently, errors in payments is suggestive of weak payment controls and, indeed, HS2 Ltd inform us that they have overhauled their controls in this area significantly since this period.

44. We have not been able to identify any formal day to day governance over the operation of the scheme itself that would allow us to demonstrate how the scheme was not open to error or manipulation by an employee. We do note that there were no attempts at a tribunal following the scheme and so there is no indication of, at least serious, error in administering the scheme.

45. We note that, following the NAO audit, HS2 Ltd have engaged KPMG to advise on updated finance and HR control frameworks as well as implementing an action plan in response to the NAO audit findings.

    Recommendation nine – *As part of an ongoing approach to updating controls, HS2 Ltd should ensure that effective and appropriate controls, which enforce senior sign off and segregation of duties, are applied. The Department should consider how it assures itself that appropriate controls are in place within the Company.*

LIMITATIONS

We have prepared this report solely for the use of the Department for Transport and its Accounting Officer following an audit conducted at a point in time and it was not written for any other purpose. Therefore, we take no responsibility for any reliance that a third party (i.e. other than the Department for Transport may place on it. Where this report has been made available to a third party, it is on the understanding that the third party will use the report only for the purpose agreed and will not distribute it or any of the information contained in it outside of the third party.

Annex A

INTERNAL AUDIT ENGAGEMENT

TERMS OF REFERENCE

HS2 Ltd redundancy schemes

To: Bernadette Kelly
DfT Permanent Secretary

From: Tim Le Mare
DfT Group Chief Internal Auditor

Cc: Gavin Gaunt
DfT, Director Group Assurance & Digital

Michael Hurn
Acting DG, High Speed Rail Group

Mark Thurston
HS2 Ltd Chief Executive

Date: 28th July 2017

Background

1. This engagement has been commissioned by the DfT Permanent Secretary following the recent regularity qualification of HS2 Limited's 2016-17 financial statements in respect of the implementation of unapproved redundancy schemes.

Audit Objective

2. The objective of this audit is to provide an independent and objective view on the governance, risk and control arrangements of the HS2 redundancy programme – within each of these three strands, the audit will seek to understand:

   Governance:

   - What were the redundancy programme's governance arrangements, how were these designed and communicated, and how did these governance arrangements align with expected practice for agreeing and administering redundancy schemes in the public sector?
   - What were the redundancy programme's approval route(s), and which governance forums - both within HS2 Ltd and DfT - played a role in commissioning, implementing and monitoring the programme? To include formal governance arrangements at both HS2 and the Department; for example the remuneration committee of HS2 Ltd and the HSR Group Board.
   - How did the different constituent parts of the HS2 programme communicate and share information about the redundancy programme in a way that facilitated open, transparent and collaborative behaviours? How did HRSG and other parts of DfT (finance, HR, legal) work together to provide a joined up view of the programme?

Risk:

- How did HS2 Ltd assess the risks to the redundancy programme, and how was this understanding shared with others?

Control:

- What controls did HS2 Ltd put in place to mitigate the redundancy programme's risks?
- How did HS2 Ltd ensure the redundancy programme was administered effectively, and not open to misuse, fraud or error?

Audit Scope and Approach

3. Throughout the audit, we will refer to sources of guidance and good practice including but not limited to: the financial delegation held by HS2 Ltd, the Framework Document between HS2 Ltd and DfT, Managing Public Money, Cabinet Office and HMT policies and the DfT guidance for shareholders of arms length bodies.
4. We will identify and evidence the approval process that initiated the scheme, obtaining a copy of the business case and identify what governance was applied to the approval of the scheme.
5. We will obtain copies of correspondence between HS2 Ltd and the DfT (and within different functions of DfT) relating to the scheme and attempt to construct a chronology of events and approvals to demonstrate where decisions were made, by whom and when. We will map these approvals to HS2 Ltd and DfT internal governance structure to identify whether any internal controls failed, were bypassed or did not robustly exist. Where robust chronologies already exist, we will seek to validate and use this rather than creating it ourselves.
6. Our review will test the communication of the redundancy scheme within HS2 Ltd and the eligibility of individuals who applied.
7. During the course of our fieldwork we will liaise with the National Audit Office team who have undertaken the statutory audit of HS2 Ltd with a view to obtaining maximum cooperation from them and so both reducing any duplicated effort and allowing the work to be completed more quickly.
8. Our audit review will be carried out as follows;
   - interviews will be held with key managers and staff;
   - relevant documents will be reviewed; and
   - testing performed as appropriate.
9. At the end of the fieldwork an exit meeting will be held to bring the main findings of the audit to management's attention in so far as is necessary to confirm factual accuracy. Our report will, however, be prepared for and supplied to the Principal Accounting Officer.

   GIAA will complete all audits to published professional standards, which requires us to consider as appropriate the adequacy and effectiveness of governance, risk management and control, including propriety, regularity, and value for money.

Scope Exclusion

We will not attempt to recalculate or to quantify the payments made to individuals, nor seek evidence of any other payments pending or made since the NAO undertook their fieldwork.