

Part 1	Introduction	Page
1.1	Purpose of FM	3
1.2	Scope of the FM	3
1.3	Purpose of BW	3
1.4	Classification of BW	3
1.5	Role of Defra	3
1.6	Review of FM	4
1.7	Review of BW	4
Part 2	Legal context	
2.1	Legal Context	4
Part 3	Management of risk	
3.1 - 3.2	Risk management framework	4
3.3	Shareholder assurance and communication	5
Part 4	Management and control systems	
4.1	The Board and Chief Executive of BW	5
4.2	Control of public funds	5
4.3	Standards and protocols	6
4.4	BW Strategy	6
4.5	BW Corporate Plan	7
4.6	Joint Ventures	7
4.7	Shareholdings and Interests in Corporate/Unincorporated Bodies	7
4.8	Project appraisal and approval	7
4.9	Contingent liabilities	8
4.10	Procurement	8
4.11	Public/Private Partnerships	8
4.12	Grant- in-aid	8
4.13	Borrowing - loans from the National Loans Fund	8
4.14	Borrowing - temporary loans from the private sector	9
4.15 - 4.20	BW Commercial activities and its Property estate	9
Part 5	Monitoring arrangements	
5.1	Monitoring and reporting	9
5.2 - 5.3	Quarterly Performance Reports	10
5.4	Annual Reports	10
5.5	Accounts	10
5.6 - 5.7	External Audit	10
5.8 - 5.10	Internal Audit	11
Part 6	Regularity and Propriety	
6.1	Application of relevant aspects of Government Accounting	11
6.2	Income	11
6.3 - 6.4	Disposal Proceeds	11
6.5 - 6.7	Insurance	12
6.8	Pensions	12
6.9 - 6.10	Claims, losses, write offs and gifts to third parties	12
6.11	Fraud and theft	13

Annexes

Page

A	Glossary of main terms and abbreviations used in this Memorandum	14
B	Corporate Governance Principles agreed with Defra	15
C	Timetable for submission of key financial information and other returns	19
D	Quarterly Business Plan Report	21
E	Consents and Guidance	22
F	Summary of approval levels	25
G	Project management process	26
H	Format for submission of projects	28
I	BW's project approval process	30

PART 1: INTRODUCTION

Purpose of FM

1.1 This Financial Memorandum (FM) is one part of the Accountability Framework for British Waterways Board ('BW' or 'the Company') which is a suite of arrangements providing for the effective governance of BW within the context of its statutory constitution. In particular the Accountability Framework establishes the respective responsibilities of the Department for Environment, Food and Rural Affairs ('Defra' or 'the Department') as the Shareholder of BW (see 1.5 below), the Board of BW as the principal governing body and the executive management as the delivery team. It has been drawn up by the DTI Shareholder Executive, Defra and BW in consultation with each other. This FM does not convey any legal powers or responsibilities.

Scope of FM

1.2 In respect of England and Wales, this FM addresses financial governance issues such as safeguarding public monies voted by Parliament; proper management of corporate financial resources; systems of control including the monitoring and management of financial and business risk; shareholder authorisation of substantial expenditure; financial propriety and compliance with applicable standards and protocols. Other documents within the Accountability Framework are:

- Corporate Governance Principles agreed with Defra on 27 June 2005 (Annex B)
- The Strategy, Corporate Plan and Annual Report
- Shareholder monitoring and reporting
- The Combined Code on Corporate Governance

A separate FM exists in respect of Scotland.

Purpose of BW

1.3 BW was established by the Transport Act 1962 to manage and maintain the inland waterways, and certain of the docks, originally nationalised under the Transport Act 1948.

Classification

1.4 For the purposes for national accounts, BW is classified as a Public Corporation. Furthermore, because its income from trading activities exceeds 50% of its overall revenues, it is a public controlled market body and as such a different budgeting and control framework to that of an Executive NDPB is appropriate¹.

Role of Defra

1.5 As regards its business within England and Wales, Defra is the sponsoring department for BW. Although BW is established by statute and is without share capital, the governance relationship between Defra and BW is described and treated under the Accountability Framework as that of 'Shareholder' and

¹ *Public Bodies: A Guide for Departments* (Cabinet Office June 2006) Chapter 7 paragraph 6.2.2

‘Company’. For national accounts purposes, the value of BW as a ‘shareholding’ is shown on the balance sheet of Defra.

Review of FM

- 1.6 This Financial Memorandum shall be reviewed after its first year of operation and on a regular basis thereafter. Reviews may be initiated at the discretion of the Department or at BW’s request. Any significant changes in levels of expenditure requiring shareholder authority will require the approval of Treasury.

Review of BW

- 1.7 As part of the policy process Defra will also periodically review or reconfirm BW’s purpose within the context of its statutory constitution and the Public Policy Objectives the Shareholder may determine from time to time.

PART 2: LEGAL CONTEXT

- 2.1 Under powers contained in the 1962 and 1968 Transport Acts² BW has responsibility for over 3,200km of canals and rivers, including statutory navigation and safety functions. With due regard to efficiency, economy and safety, it has the duty to provide services and facilities on the inland waterways and port facilities owned or managed by them. BW also has the duty to exploit commercial opportunities to raise income in support of its navigation and safety function and the duty to act as if it ‘were a company engaged in a commercial enterprise in its non-navigation commercial activities’.

PART 3: MANAGEMENT OF RISK

Risk Management Framework

3.1 Risk Management Framework

BW shall maintain a robust framework to manage risk that fully incorporates effective risk management. These processes should be embedded as far as possible into the everyday management of BW. The risk framework will comprise the following five key elements:

- a culture which supports well thought out risk taking and promotes learning from experience of managing risk
- a corporate risk policy that sets out the overall approach to risk management
- effective processes for identifying, assessing, addressing, and reviewing and reporting risks
- clear allocation of ownership of risks and delegation of authority for taking risks.

Ensuring that the risk framework is fit for purpose shall be a key responsibility of the Board, supported by the work of its Audit Committee.

² Abbreviated to 1962 Act and 1968 Act respectively in the text that follows. Other terms and abbreviations are explained in Annex A.

- 3.2 In accordance with its duty to act as if it “were a company engaged in a commercial enterprise” in its non-navigation commercial activities, BW shall seek to obtain the best overall return in the context of an acceptable level of risk. Its Investments Strategy, agreed by the Board and the Shareholder, establishes the overall risk/return balance of its activities portfolio, and is therefore a key element in articulating the level of exposure which is considered tolerable and justifiable and how much is actively put at risk for the benefits of the opportunity.

Shareholder assurance and communication

- 3.3 There will be regular and open discussion of risk issues with Defra. BW shall provide such reasonable assurance as the Department requires of the effectiveness of its risk management through its monitoring and reporting arrangements, by audit processes (internal and external) and by engagement with the Board of BW. BW will communicate its key risks to Defra as part of the quarterly exchange of information within the reporting framework set out in Part 5. The Board will also report to Ministers on BW’s process for risk identification and management in the Annual Report laid before the Houses of Parliament.

PART 4: MANAGEMENT AND CONTROL SYSTEMS

The Board and Chief Executive of BW

- 4.1 The Board of BW is responsible for all aspects of BW’s organisation and performance. The Chair has a particular responsibility for the proper discharge by the Board of its collective role, and compliance with this FM. This includes compliance with BW’s statutory responsibilities such as the signing of the accounts and statement for inclusion in the Annual Report and Accounts and guidance in Government Accounting and other instructions issued by Treasury, Cabinet Office and Defra where applicable. The Board is responsible for the appointment of the Chief Executive of BW who is responsible for the day to day operations of the organisation and the regularity and propriety of its activities in accordance with the Treasury Guidance on Regularity and Propriety where applicable. In accordance with the provisions of the 1962 Act and the OCPA Code of Practice, the Secretary of State will, in consultation with Scottish Ministers, appoint the Chair and, in consultation with the Chair, Board members. The remuneration of the Board will be in accordance with Treasury guidelines.

Control of Public Funds

- 4.2 BW shall have appropriate management and control systems in place so that it can demonstrate proper stewardship of public funds provided to it and that it is able to manage and account for public funds properly and effectively. The management and control systems shall ensure that:
- the Board and Chief Executive take effective responsibility for the proper use of public funds
 - BW’s activities conform with the requirements of propriety and regularity³

³ as set out in Annex 4.1 of Government Accounting

- high standards of internal control are maintained to ensure that internal procedures meet the applicable requirements of Government Accounting
- no funds are used for any expenditure of a novel, contentious or repercussive nature without approval from Defra and HMT.

Standards and protocols

4.3 BW will comply with the following Corporate Governance requirements or expectations where applicable, in respect of:

- This document
- Government Accounting
- Government Internal Audit standards (GIAS), issued by Treasury
- Managing the Risk of Fraud
- Regularity and Propriety, issued by Treasury
- Combined Code of Corporate Governance
- the Principles established by the Committee on Standards in Public Life
- HM Treasury Code of Conduct for Members of Public Bodies
- Modern standards of openness and accountability including compliance with the Cabinet Office Code of Practice on consultation, Customer Charter, Freedom of Information Act and maintenance of effective complaints procedures
- Waterways Ombudsman scheme
- Assisting Defra in its appointment of Board Members in accordance with the guidance of the Office of the Commissioner for Public Appointments
- Competition and fair trading requirements
- Appropriate pensions fund management
- Management and reporting of remuneration of Executive Directors

Compliance with these standards shall be monitored by the Audit Committee using internal and external audit. Any significant exceptions identified by external audit will be reported to Defra.

BW Strategy

4.4 The Board, working with the executive management, determines a long term Strategy ('the Strategy') to achieve BW's Public Policy Objectives as determined by the Shareholder (the current Objectives being set out in the latest Policy Review). The Shareholder and the Board will agree this Strategy, as well as periodically reviewing progress, annually at one of the Quarterly meetings. The Strategy will incorporate the Public Policy Objectives, agreed network standards and other requirements but detailed implementation plans for these, and the necessary performance metrics to monitor progress on them, will be included in the 3 year rolling Corporate Plan (see below).

BW Corporate Plan

4.5 To complement the long term Strategy, BW executive management will prepare a more detailed 3 year rolling Corporate Plan ('the Plan') to deliver the Strategy.

A draft of the Plan will be submitted and agreed with the Board and Shareholder in accordance with an agreed timetable and revised on an annual basis. Progress against the Plan will be regularly assessed as part of the performance monitoring/interaction process (see Part 5). The quarterly performance reports will also incorporate the Key Performance Indicators to monitor progress. Progress against Key Performance Indicators will be covered in the Annual Report and Accounts.

Joint Ventures

- 4.6 Before negotiating a joint venture and seeking the Department's approval to do so, BW should ensure that:
- a the choice of participant (where available⁴) is subject to open competition in accordance with EU procurement rules,
 - b in respect of any BW assets provided to the venture, the option of outright disposal is kept open to be considered alongside partnership bids
 - c the nature and purposes of the venture are consistent with BW's powers and objectives,
 - d all reasonable alternative options have been considered, including doing nothing, and a full financial analysis has been undertaken,
 - e a robust sensitivity and risk analysis has been undertaken and adequate safeguards for BW are available, such as BW's ability to sell or assign its interest, and
 - f HM Treasury have been satisfied that the venture entity will not be classified by ONS as a public body.

Shareholdings and interests in Corporate/Unincorporated Bodies

- 4.7 Except in the circumstances in Annex E, BW requires the Secretary of State's consent⁵ before subscribing for or acquiring securities in corporate bodies. BW should seek the Department's prior approval before acquiring any interest in other bodies.

Project appraisal and approval

- 4.8 Substantial expenditure by BW in developing land requires Shareholder consent⁶. Furthermore, substantial outlay on capital account by BW shall be on lines settled from time to time with the Shareholder⁷. Accordingly, BW shall secure the prior approval of the Department before entering into any such financial commitment which exceeds the generally authorised levels summarised in Annex F. Submissions for approval should be made by a person (normally the Commercial Director) notified to the Department as authorised to do so on behalf of the Board and should contain the information stipulated. Except in exceptional circumstances, the BW Board should approve any commercial property related project before submission to the Department. The general approach for approving projects is set out in Annex H. BW shall maintain and operate a documented appraisal and authorisation procedure for

⁴ In Joint Ventures involving owners of neighbouring property with marriage value, no choice may be available.

⁵ Section 14(4) TA62

⁶ Section 11(3) TA62

⁷ Section 27(2) TA62

all projects (whether capital, maintenance, estates, research or administration). BW staff undertaking appraisals should be trained to carry out the documented procedures. The description of BW's internal processes is at Annex I.

Contingent liabilities

- 4.9 BW shall not lend money, charge any asset or security, give any guarantee or indemnities or letters of comfort, or incur any other contingent liability above £250,000 except with the approval of the Department. It shall report to the Department on any contingent liabilities incurred otherwise than in the course of its normal trading activities.

Procurement

- 4.10 BW's procurement policies shall reflect guidance from the Office of Government Commerce. BW shall also ensure that it complies with any relevant EU or other international procurement rules. All contracts let by BW, whether for works (capital or maintenance), consultancies, stores or services should be designed to secure value for money and periodically benchmarked against best practice elsewhere. They should be let on a competitive basis. BW shall prepare and maintain internal instructions which ensure that the number of tenders sought for each contract is consistent with the best public sector practice.

Public/Private partnerships

- 4.11 Where appropriate, BW should consider the scope for developing Public/Private Partnerships (including Private Finance Initiative projects), for developing and improving existing services, for the development of new services and to obtain the benefit of new capital investment. In considering the scope for improving and developing such projects, BW should have regard to existing Government, particularly Treasury, guidance. Wherever practicable BW should have regard to exposing activities undertaken by its own employees to outside competition and, at the Board's discretion, arrange for activities to be contracted out where this would improve value for money. Where cash flow projections may result in delegated spending authority being breached, BW should consult Defra.

Grant in aid

- 4.12 Defra will pay BW grant-in-aid to facilitate the execution of BW's statutory obligations with regard to the canal network. The grant will be paid to BW in monthly instalments on the basis of a written application showing evidence of need in accordance with Treasury guidelines and the general principle enshrined in Government Accounting. This grant forms part of the 'Resource' section of Defra's Departmental Expenditure Limit (DEL) and will be announced to Parliament at the start of each financial year. BW will keep funds provided as grant-in-aid in a separate bank account from that used for commercial capital. Further guidance is provided in Chapter 11 (Public Corporations) of Consolidated Budgeting Guidance (2007-08).

Borrowing - loans from the National Loans Fund

- 4.13 BW may borrow⁸ funds for purposes agreed by the Department and the Treasury in accordance with Chapter 29 of Government Accounting.

Borrowing - temporary loans from the private sector

- 4.14 BW's annual application for a Treasury Guarantee for temporary borrowing should be submitted to the Department no later than the end of the second week in February prior to the financial year in which the borrowing is required. Justification for the level of Guarantee required should accompany the application.

BW Commercial activities and its Property estate

- 4.15 For its commercial activities, BW is required "to act as if [it] were a company engaged in a commercial enterprise"⁹. Furthermore, as noted in the 2005 policy review, the BW Board is responsible for making efficient economic use of the assets at its disposal in order to achieve agreed Corporate Plan targets.
- 4.16 Defra will look to the Board to seek to obtain the best possible overall return from its commercial activities, within a reasonable timescale and an appropriate level of risk in line with the Investment Strategy agreed with Government.
- 4.17 For the purposes of commercial activities, 'operational' and 'non-operational' assets will be considered interchangeable. BW should maximise, as far as possible, revenue from its activities by charging the market rate for its services. BW should keep cash balances at the minimum level consistent with efficient operation, while acknowledging that BW may find it difficult to match income immediately from estates transactions with re-investment opportunities.
- 4.18 In determining how best to make use of non-operational properties, BW shall be free to act within the guidance and consents set out in Annex E. Proceeds from the disposal of non-operational property may be held in reserve for reinvestment in the current or future years in revenue-earning properties and other activities related to the current and prospective use of the waterways.
- 4.19 BW may hold surplus capital receipts in a reserve as deposits and use them to increase planned expenditure on capital in the current year or subsequent years, provided BW can demonstrate, during the annual revision of the 3-year Plan, that the use of these deposits will maintain or enhance progress in implementing the agreed strategy. No grant in aid can be held as a deposit, and the amount held in deposits will be shown in the monthly flow of funds statements.
- 4.20 While BW will be entitled to retain the financial proceeds from its activities for re-investment, the use of receipts significantly in excess of those projected in the Corporate Plan will be discussed as part of the strategic review and, in certain circumstances, a reduction in the annual grant- in- aid may be appropriate.

⁸ Section 19, Transport Act 1962 provides powers for BW to borrow

⁹ Section 134 TA68

PART 5: MONITORING ARRANGEMENTS

Monitoring and reporting

5.1 In its capacity as BW Shareholder, Defra will have a number of requirements with regard to the monitoring of specific areas of BW's operations and processes. This will take the form of reports based on various financial, commercial and network metrics, coupled with a number of statutory requirements and audit assurances. A summary of such processes is set out below and in Annex C.

Quarterly Performance Reports

5.2. Performance monitoring and regular interaction with BW will form a key element in allowing Defra to discharge its shareholding responsibilities and provide due scrutiny over BW's operations. The monitoring framework will allow Defra to assess BW performance against the BW plan and gain a wider understanding of the operational, financial and commercial issues affecting its shareholding. Subsequent discussions with management will be at an appropriately high level to address.

5.3 BW will report on performance to Defra on a quarterly basis: this report will be submitted in advance of the quarterly shareholder meetings with Defra. The specific detail of the report agreed with BW as per Annex D will include:

- financial performance
- operational efficiency
- progress against Defra policy
- commercial property dynamics (including ventures updates)
- principal BW risks.

Annual Report

5.4 At the end of each financial year, BW shall publish an annual report of its activities together with its audited annual accounts. A pre-publication copy of the report shall be submitted to Defra in accordance with an agreed timetable. The report and accounts shall be laid before Parliament in accordance with the guidance on the procedures for the presenting and laying of the combined Annual Report and Accounts. This will include a requirement for BW to comply with:

- a the accounting and disclosure requirements of companies legislation currently in force to the extent required by the Accounts Direction issued under s.24 of the 1962 Act,
- b the accounts disclosure requirements of paragraph 43 of Chapter 12 of the Financial Services Authority listing rules, and
- c proper commercial accounting practice as defined by UK Generally Accepted Accounting Practice (UK GAAP) and accounting standards such as IFRS adopted or issued by the Accounting Standards Board.

In so doing, the Annual Report will include an Operating and Financial Review.

Accounts

5.5 The BW Chair and Chief Executive will jointly sign BW's accounts. BW will adopt accounting systems compatible with legislation and the Accounts Direction issued by the Department¹⁰ (with the approval of the Treasury), and its business as defined in the Corporate Plan. The Department expects to lay copies of BW's Annual Report and Accounts before Parliament before the summer recess (normally the end of July). A timetable for meeting this target shall be agreed between the Department, BW and its auditors. BW shall also send accounts of its associated companies to the Department within an agreed timetable.

External Audit

5.6 The Board and Audit Committee will select external auditors to recommend for appointment by the Secretary of State¹¹. BW shall bear the audit expenses. Subject to satisfactory performance the auditor shall be reappointed annually. The frequency of re-tendering shall be in accordance with current Treasury guidance.

5.7 External auditors will be responsible for reporting on:

- a the preparation of BW's accounts in accordance with the Accounts Direction and any other direction as required by Defra (such report to be addressed to the Board who are required to send it to the Secretary of State),
- b Regulatory Compliance with the relevant principles of Government Accounting (insofar as they relate to Public Corporations) and other requirements as detailed in their appointment letter (such report to be addressed to the Secretary of State), and
- c the scope, nature and effectiveness of the Board's Internal Audit processes in meeting GIAS (such report to be addressed to the Board and copied to the Secretary of State).

Internal Audit

5.8 It is the responsibility of the Chief Executive to maintain an effective internal audit service in accordance with the standards, objectives and practices set out in an appropriate professional standard. The internal audit service shall provide an independent appraisal and evaluation of BW's internal control systems, ie the whole network of systems and controls established by BW to deliver its objectives with regularity, propriety and value for money.

5.9 The Board shall incorporate within its annual report to the Secretary of State a statement to confirm that BW's internal audit arrangements accord with the objectives, standards and practices set out in GIAS.

5.10 Defra's Internal Audit Service shall have a right of access to all documents prepared by BW's internal auditor, including where the service is contracted out.

¹⁰ The last accounts direction was issued in May 2005

¹¹ Section 24(2) TA62

PART 6: REGULARITY AND PROPRIETY

Application of relevant aspects of Government Accounting

- 6.1 BW will comply with Government Accounting where specific reporting requirements are necessary.

Income

- 6.2 BW has to maximise, as far as possible, revenue from its commercial activities by charging the market rate for its services. Receipts from operational activities are internal resources. Any receipts which are additional to those estimated in the Corporate Plan may be used to increase expenditure in the year they arise.

Disposal proceeds

- 6.3 In managing its non-operational estate, BW shall seek to obtain the best possible overall return within a reasonable timescale and the context of an acceptable level of risk and the Investment Strategy agreed with Defra. BW's estimated disposals proceeds will be taken into account, and asset investment levels set, in the annual Planning process.
- 6.4 It is recognised that, in order to comply with its statutory obligation to act as if it "were a company engaged in a commercial enterprise", and in order to optimise income from its estates portfolio, BW may find it difficult to match closely income from estates' transactions with planned re-investment opportunities. Examples of matching difficulties which will leave BW with surplus receipts are:
- a additional receipts (in excess of plan levels) received in the current year, or
 - b due to circumstances beyond BW's reasonable control, planned receipts received too late to be re-invested as anticipated within the current year, or
 - c due to circumstances beyond BW's reasonable control, issues arise in connection with re-investment opportunities which make it inappropriate or inadvisable to complete the project within the current year.

Insurance

- 6.5 BW may act in accordance with good insurance practice for commercial bodies and may insure to the level that is appropriate to the business.
- 6.6 Such insurance arrangements may include self insurance through a captive insurance subsidiary (subject to all necessary authorisation) that operates in accordance with EU Insurance Directive requirements.
- 6.7 BW shall review the management of its insurance from time to time to ensure that the risks it faces are dealt with in an appropriate manner and shall make a return to the Department every three years setting out details of its current insurance policies and highlighting any changes as appropriate.

Pensions

- 6.8 Under section 73 of the 1962 Act BW may pay pensions and enter into obligations under pension schemes. BW operates a defined benefit funded pension scheme pursuant to those powers. BW shall maintain effective arrangements for monitoring the performance of the pension fund, in

accordance with good commercial practice. BW should ensure that the fund itself makes adequate arrangements for the supervision of the investment managers and should also seek independent annual measurements of the comparative investment performance of the fund. The Department will monitor BW's pensions operations in accordance with Treasury guidance. Each year BW shall submit to the Department the Annual Report and Accounts of the pension fund, those of British Waterways Pension Fund Trustees Ltd and any supporting information required by the Department to fulfil its monitoring role. Every three years a full actuarial valuation of the pension fund should be carried out. The actuary's report on the valuation shall also be sent to the Department.

Claims, losses, write offs and gifts to third parties

- 6.9 BW shall keep a record of all losses, write offs, compensation payments and gifts to third parties, available for inspection if required. Further guidance on gifts is at Annex E. BW shall report to the Department on material losses, write-offs and compensation payments in the Annual Report and Accounts. A loss may be material for either financial or reputational reasons or both.
- 6.10 The prior approval of the Department shall be required for any agreement by BW to make any compensation or loss payments which exceed £2 million or (if less) are 'novel, contentious or repercussive'. Any non-voluntary payments of such nature (eg pursuant to an order of a court) shall forthwith be reported to the Department. Treasury guidance and where necessary approval must be sought whenever necessary or appropriate.

Fraud and theft

- 6.11 Any novel or material (financial or reputational) fraud or suspected fraud, whether involving a member of BW or a third party, must be reported immediately to the Department. An annual report on all reported fraud and theft shall be made to the Department.

Martin Hurst
On behalf of the Secretary of State for
Environment, Food and Rural Affairs

Date: March 2007

Robin Evans
On behalf of British Waterways

Date: March 2007

Annex A

Glossary of main terms and abbreviations used in this Memorandum

The Board	The Board managing British Waterways, appointed by the Secretary of State
BW or 'Company'	British Waterways
Chief Executive	The senior executive director in BW (appointed by the BW Board)
Defra, the Department or the 'Shareholder'	Department for Environment, Food and Rural Affairs (Defra), including the Secretary of State and those acting on his/her authority.
GIAS	Government Internal Audit Standards
Green Book	Treasury guidance on economic appraisal and evaluation in central government
OCPA	Office of the Commissioner for Public Appointments
Red Book	Royal Institute of Chartered Surveyors' Appraisal and Evaluation Standards
Secretary of State	The Secretary of State for Environment, Food and Rural Affairs and those acting on his/her authority.

Annex B

BRITISH WATERWAYS CORPORATE GOVERNANCE PRINCIPLES

Background

1. British Waterways is a statutory public corporation established by the Transport Act 1962, as amended and supplemented by the Transport Act 1968 and other legislation. The governance framework provided by those statutes is the equivalent of the Memorandum and Articles of Association for a limited company (though with less detail and precision). Hence in this document the Government (and in particular the Minister acting through the Department) is described as “the Shareholder” and British Waterways as “the Company”.
2. This document is intended to explain how the relationship between the Company and the Shareholder should work so as to maximise the success of the business consistent with BW’s underlying statutory provisions.
3. Considerable discretion is delegated to the Board under BW’s governing statutes that broadly follow the Companies Act model. A key provision concerning the Shareholder’s powers (s.27 TA 1962 entitled ‘Powers of Ministers in relation to Boards’) provides that powers of general direction are limited to “directions of a general character as to the exercise by the Board of their functions.....in relation to matters which appeared to him to affect the national interest.” The Public Corporation model (as compared to an Executive Agency) requires an arms length relationship with the Shareholder who exercises no direct executive control over the business. The governance regime will acknowledge these powers of the Board together with the legitimate rights of the Shareholder to exercise effective scrutiny as owner of the Company.
4. Specific powers of direction are reserved for a few particular acts or events, but the statutory governance framework clearly gives the Board significant discretion to devise the strategy necessary to meet the public policy objectives determined by the Shareholder. Nevertheless the absence of financial market disciplines on the Board means that its powers as described are predicated on the presence of effective shareholder scrutiny which is intended to enhance value in the business.
5. The best practice governance arrangements for government owned businesses being put in place for other public corporations will apply equally to BW. However, as guardian of a unique national asset with particular heritage, amenity and environmental value, BW has a wider breadth of responsibility than the duty of a typical limited company to its shareholder. This is dealt with in the Public Policy Objectives as set out in the 2004/2005 Policy Review of BW. Thus the Board has additional considerations not usually encompassed in a standard shareholder and company relationship. These additional responsibilities are taken into account by the Shareholder in decisions on Board composition and in terms of the broader range of matters the Board itself is required to take into account in its governance of its business.
6. As a public body, BW is required to meet standards of openness and accountability (e.g. Freedom of Information) applicable to other public bodies. In addition, as a body with significant commercial activities it will also meet standards of accepted best practice under the relevant provisions of Combined Code on Corporate Governance.

Key Principles

- The Shareholder sets Public Policy Objectives for the Company that meet the national interest and will include strategic financial performance targets. (All subsequent references to Public Policy Objectives should be taken to include relevant financial performance targets).
- The Board is the principal instrument of governance of the Company and, under the leadership of its Chairman, has collective responsibility for the performance of the duties placed upon it by the statutes in a manner that achieves the Public Policy Objectives of the Shareholder to whom it is accountable.
- The Board, working with the executive management, determines a Strategy to achieve those Public Policy Objectives.
- The Shareholder and the Board agree the Strategy and the measures by which the success of the Strategy in meeting the Public Policy Objectives is evaluated.
- The Board and the Shareholder periodically review progress of the Strategy in delivering the Public Policy Objectives.
- The Board approves a Corporate Plan for delivery of the Strategy that is prepared by the executive management. The Corporate Plan will include measures against which the Board will evaluate performance in delivery of the Strategy.
- The Board discuss the Corporate Plan with the Shareholder to enable effective measurement of progress in delivering the Strategy.
- The involvement of the Shareholder as outlined in this paper is intended to be value enhancing

The Board

7. The composition of the Board is a critical factor for the Shareholder and the Shareholder's power of appointment (and, *in extremis*, removal) is a key instrument of the Shareholder in the exercise of its influence. It will therefore be a key responsibility of the Shareholder to ensure, working with the Chairman of the Board, that the Board contains an appropriate combination of the necessary skills and experience for both the effective direction of a complex business and oversight of the public interest. To achieve this, the following will take place:
 - 7.1 In accordance with the provisions of TA 1962 the Secretary of State will, in consultation with Scottish Ministers, appoint the Chairman and additionally in consultation with the Chairman, appoint the other members of the Board. The Chairman will consult with the Minister periodically as to the most appropriate size and "shape" of the Board. During each year the Chairman will discuss with the Shareholder any impending changes to Board membership;
 - 7.2 The appointment process will be in accordance with the Code of Practice for Ministerial Appointments to Public Bodies issued by OCPA and will, so far as not incompatible, also follow the recommendations of the Combined Code on Corporate Governance. To those ends the Chairman will use the Nominations Committee of the Board for providing best advice to Ministers on any particular appointment.
 - 7.3 The Shareholder acknowledges its responsibility, when exercising its powers to determine the terms of appointment, of ensuring that Board members' remuneration is appropriate to incentivise applications from persons of calibre with the desired qualities.

- 7.4 The Board will annually evaluate its own performance in accordance with the recommendations of the Combined Code on Corporate Governance. The outcome of the evaluation will be shared by the Chairman of the Board (and where appropriate the Board Nominations Committee) with the Shareholder.
- 7.5 The Board recognises that one of its key responsibilities is the setting of appropriate remuneration and incentives for the executive management team to ensure the Executive is properly incentivised to deliver the Corporate Plan. The Shareholder looks to the Board to develop an appropriate remuneration framework for the Company through the use of a Remuneration Committee which will set executive remuneration. The Board and its Remuneration Committee will follow best practice in accordance with the Combined Code on Corporate Governance.

Company Purpose and Public Policy Objectives

8. The Shareholder recognises the need to clearly articulate its Public Policy Objectives for the Company. As part of that policy process it will also periodically (re) confirm the company's purpose within the context of the Public Policy Objectives the Shareholder may determine from time to time.
9. The primary purpose of the Company is to manage, maintain and develop its network of waterways and docks for the wider public benefit. The 2004/05 Policy Review of BW clarified these aims and will serve as the strategic objectives for the Company until they are revised.

Confirming Strategies and Agreeing the Corporate Plan

10. The Shareholder recognises that it is the responsibility of the Board of the Company to approve an appropriate set of business strategies put forward by the Chief Executive ('the Strategy') that will deliver the Shareholder's Public Policy Objectives consistent with the Company's purpose as defined. The Strategy will be subject to in depth review and challenge by the non-executive Board prior to adoption.
11. A process will be defined under which the Strategy will be agreed with the Shareholder. All concerned will ensure that there is a common understanding of the agreed Strategy between the Shareholder, the Board and the Executive.
12. As part of this, the Chairman and Chief Executive will explain to the Shareholder how the Strategy is aligned to delivering the Shareholder's Public Policy Objectives and any specific shareholding objectives it may have.
13. A rolling 3 Year Corporate Plan derived from the Strategy will be discussed annually with the Shareholder. The Corporate Plan will include appropriate milestones and metrics against which performance in delivering the Strategy can be measured. The longer term strategic plan will also be available to the Shareholder if required.

Performance Reporting

14. The Shareholder will agree an appropriate process with the Board of the Company to review the progress of the Strategy in meeting the Public Policy Objectives of the Shareholder. This process will be based on the following key principles:
 - 14.1 The focus will be high level, primarily on strategic financial milestones, reported to the Shareholder quarterly as agreed at the time of the Policy Review in 2004-05.

Funding Contract Monitoring

15. To allow the Shareholder to focus on strategic issues, the measuring and monitoring of operational performance under the funding contract will be distinct and separate from consideration of the strategic milestones referred to above.

16. The Contract will also provide for appropriate audit of contractual performance that will enable officials to confirm the propriety of public funds disbursed.

Powers exercisable subject to Ministers Consent

17. Section 28 Transport Act 1962 provides that where the Company is required by statute to obtain the consent of the Minister to any action, such consent may be given for any case or description of cases, or may be general, and may be given subject to conditions. As an appendix to this document there shall be a schedule of general ministerial consents and related financial authorities as determined from time to time by the Minister. The Company and the Shareholder agree to keep the schedule under review and to ensure that it appropriately reflects the principles set out in this document.

Working Together

18. The Company and the Shareholder agree that the interactions between them need to be underpinned by resolve on both sides to conduct business through trust based dialogue in a professional and efficient manner reflecting the following:
- Trust Based: open dialogue based on a shared commitment to meet the Public Policy Objectives that will provide the Company with the framework for success.
 - Professional: competent people with the relevant experience to be able to engage in informed dialogue relevant to creating value for the Company and its Shareholder with mutual commitments to deliver on time and to specification.
 - Efficient: both parties ensuring a joined up approach amongst their constituent parts with single statements of requirements that avoid duplication and unnecessary analysis
19. The Company and the Shareholder agree that there will be different elements to the relationship between Shareholder and the Company and the primary contact points will vary as a result. This will reflect the three separate but related roles of the Department:
- as Shareholder,
 - as purchaser of services under the Contract; and
 - as government sponsor of the Company.
20. The primary contact points will normally be as follows:
- Shareholder Meetings - Ministers and senior advisors from the Department or Shareholder Executive with the Company Chairman / Chief Executive and Finance Director
 - Contract Meetings - More junior Departmental officials with members of the Company Executive / their management teams
 - Sponsorship Matters (PQ's etc) - As appropriate to the matter in hand

Both parties will arrange its representation so as to avoid duplication.

Parliamentary and Other Accountabilities

21. Notwithstanding the above governance principles and respective division of roles and responsibilities, the Shareholder and Company recognise the need to support and assist each other in their respective accountabilities; in particular to support:
- the need of ministers to respond timely to Parliamentary and intra-governmental questions and requests for information;
 - the need for ministers and / or officials to respond timely to other public enquiries;
 - the need for the Company to respond timely to issues arising under its accountability mechanisms, including the British Waterways Advisory Forum; and
 - the need for ministers to review, modify or change from time to time the Public Policy Objectives.

Annex C

TIMETABLE FOR SHAREHOLDER INTERACTION AND INFORMATION EXCHANGE

- 1 The timetable below has been agreed for the sharing of information between BW and Defra. The timetable and its content may be varied in the light of experience. Where shareholder meetings are held in any month in which there is a Board meeting, the shareholder meeting shall follow the Board meeting. In general terms there are a number of issues which lend themselves to annual reporting, and feed into an annual cycle of discussions on planning (including future expenditure on assets) such as:
- Long-term income profile, showing in particular any changes in assumptions on venture income, but also including other issues, such as fees and charges
 - Evolution of network asset 'health' – to date and projected over the current Comprehensive Spending Review period, eg movement of the proportion of assets in each condition category
 - the deliverables by which Government's requirements for the canal network are to be delivered, ie network reports
 - Benchmarking reports (ad hoc or regular) on an agreed basis.

Timetable

Third week of every month	Application for grant in aid for following month (from FD/other authorised person) Monthly flow of funds statement
April (QSM months in Bold)	Quarterly Business Performance report* Quarterly shareholder meeting including P10 results and F10 full year forecast, Final Business/Corporate Plan, Annual report on network 'health' and grant use Annual return on de minimis disposals and those not subject to open market competition (Annex E, paragraph 6) Annual report on customer satisfaction and visitor numbers
June	Final outturn figures for preceding financial year Draft Annual Report and Accounts (as approved by Board -paragraph 5.4) Annual report on fraud and theft (paragraph 6.5) Report on contingent liabilities (paragraph 4.10)
July	Annual report on compensation payments and losses (paragraph 6.4 and Annex D) Publication copy of Annual Report and Accounts (paragraph 5.4) List of all projects over £500,000 let between January and June (Annex F, paragraph 11) Quarterly Business Performance report* Quarterly Shareholder Meeting including P3/F3 results Annual in-depth property review ¹²
31 August	Quarterly financial statement Annual report and accounts of the BW pension fund and BWPF Trustees Ltd. (paragraph 6.3)

¹² This in addition to the regular property reporting piece in the Quarterly Pack

November	<p>Quarterly Business Performance report*</p> <p>BW submit Directors' priorities for next 3 year BW Business Plan/Corporate Plan and target figures for the next 3 years showing how plan to live within target.</p> <p>Quarterly Shareholder Meeting including Annual discussion on Long Term Strategy, P6 (half-year) results and F6 full year forecast</p>
January	<p>Quarterly Business Performance report*</p> <p>Quarterly shareholder meeting including Business Plan progress and issues, P9 results and F9full year forecast,</p> <p>Annual Venture Business Plans report,</p> <p>Priorities for Business Plan/ Corporate Plan inclusive of high level figures before finalised,</p> <p>List of all projects over £500,000 let between July and December (Annex E, paragraph 11)</p>
2nd week in February	Application for Treasury guarantee of temporary borrowing (paragraph 4.14)
March	Business/Corporate Plan as approved by the Board.

Next triennial return on Insurance (paragraph 6.2) due in 2007

Next triennial valuation of BW's Pension Fund (paragraph 6.3) due in 2007

***See Annex D re the content of the Quarterly Business Performance Report**

Annex D

QUARTERLY BUSINESS PERFORMANCE REPORT

- 1 The performance report to Defra should reflect that to the BW Board whilst recognising that there may be differences in the level of detail and overall emphasis/balance of the content. The key areas to be covered are as follows:

Financial	CBIT for individual business areas*; cash flow, balance sheet performance data*
Commercial Property	Portfolio return by investment/ventures * appropriately segmented, including capital, income and returns, transfers in and out of the portfolios, and cost of capital against appropriate benchmarks.
Leisure	BW income/(costs)*
Joint Ventures	BW income/(costs)*
Defra authorised Projects	Costs/income (net/gross/forecast/outturn); borrowing/gearing; IRR (including any adjustments); milestones.
Core Waterways costs	Operating breakdown; regional breakdown; efficiency measure (with effect from October 2007)
Restoration	Income/Contribution; commentary
Costs	Central overheads; regional costs (ytd; full year)
People	Headcount (current, previous data, years 2 and 3 of plan)
Risk	a copy of the dartboard and risk register which goes to the Board; including any report on portfolio risk
Customers/Stakeholders	Measure(s) of stakeholder satisfaction, based on customer survey
Assets	Asset Condition; consequence of failure; unscheduled closure
Waterways Standards	% of minimum acceptable standards met by region and functions
Sustainability Reporting	To be developed (available from autumn 07).
Value and movement towards or away from financial self-sufficiency	For example, the net value of BW's projected income and expenditure streams and arrears valuation.

*(ytd; full year; previous year; years 2 and 3 of plan)

- 2 BW will advise Defra of the dates when this information will be available so as Shareholder Meetings can be scheduled around two weeks later.

Annex E

Consents and Guidance concerning property transactions and commercial activities

Overview

1. In managing its properties BW has the following broad options:
 - a retention (alone or in joint venture) of properties for investment purposes
 - b outright freehold or long leasehold sale
 - c development through profitable joint ventures or other collaborations
 - d acquisition and improvement of land under BW's powers in the 1962 and 1968 Transport Acts
 - e acquisition and disposal of operational properties in accordance with business needs taking into account the requirements of efficiency and economy.
2. In accordance with its duty to act as if it "were a company engaged in a commercial enterprise", BW shall exercise such options with a view to obtaining the best overall return in the context of an acceptable level of risk and the Investment Strategy agreed with Defra.

Investment properties

3. BW should establish criteria for deciding whether or not to retain properties for investment purposes. These criteria should include BW values, prospects for future development, minimum net return and operational links. They should be regularly reviewed.

Disposal

4. Prior Departmental agreement should be sought where:
 - a disposal is not subject to open market competition and, except in the case of *de-minimis* disposals outlined at paragraph 5 below, a certificate from an independent valuer that disposal is at market value has not been obtained, or
 - b there are features of the disposal that do not or may not comply with the requirements of regularity and propriety and good financial management, including related party transactions.

De-minimis disposals

5. BW may dispose of low value properties in the absence of an independent valuer's certificate, without reference to the Department, where the value of the property determined using the arrangements set out below does not exceed £200,000. In such cases BW shall:
 - a before negotiations start obtain from a qualified surveyor or valuer who is not involved in the disposal an assessment of the open market value of the property and, where appropriate, an assessment the price likely to be paid by a special purchaser (if the book value was established by an independent valuation carried out within the preceding twelve months; there is no reason to assume a sale to a special purchaser, and if there have been no material changes in the factors affecting the value, the assessment may be limited to a confirmation of the book value); and

- b before the transaction is completed, obtain a certificate from a qualified surveyor or valuer (who may be employed in-house) to the effect that the final price is the best price reasonably achievable.

This certificate should normally be given by the valuer who made the original valuation assessment. Where this is not possible, the surveyor valuer giving the certificate should not have been involved in the disposal. When appropriate the report should give the reasons why a lower figure is now considered reasonable.

- 6 BW will report at the end of the financial year on the number of de-minimis disposals by region, giving the total value of such disposals and the percentage relationship to all disposals by number and value. The return will also include the figure for the largest *de minimis* sale in each region.

Land acquisition and improvement

- 7. In accordance with Annex F, general consent for expenditure in the development of land under its statutory powers¹³ is hereby given to BW where the value of the land to be acquired, or the value of BW investment for development, does not exceed £6 m (or for the purchase of property only £10 million). This delegated level of authority may be reviewed from time to time.
- 8. Specific consent shall be required for any expenditure described in paragraph 7 where:
 - a the value of the land to be acquired, or the value of BW investment for development, exceeds £6m (or for the purchase of property only, ie not incurring development expenditure £10 million), or
 - b open market competition is not intended, or
 - c there are novel, contentious or repercussive features.
- 9. The consent of the Treasury, in addition to that of the Department, shall be required where the value of the land to be acquired, or the value of BW investment for development, exceeds £10m (or for the purchase of property only £15 million).
- 10. BW should consult the Department at the earliest stage in the case of development proposals requiring the Department's consent. Guidelines for the submission of proposals for consent are contained in Annex H.
- 11. At the beginning of January and July each Year BW shall submit to the Department a list of all development projects (land acquisition and/or improvement) involving expenditure above £500,000 (inclusive of fees) authorised within the previous six months.

Acquisition of securities

- 12. BW requires the approval of the Department for the subscription to or acquisition of any securities of a corporate body, except where:
 - a subscription or acquisition is in connection with a joint venture arrangement for the purposes of trading or estate management related to BW's business
 - b the value of any securities to be subscribed for or acquired does not exceed £250,000 for each corporate body
 - c BW's interest in each corporate body does not exceed 49%

¹³ Section 11 TA62 as enlarged and supplemented by section 49 TA68

- d the risks and liabilities arising from cost sharing agreements etc and the degree of BW's control over the corporate body's activities are in proportion to BW's interest in the corporate body, and
 - e BW acquires no contingent liabilities.
13. BW should consult the Department at the earliest stage in the case of proposals to subscribe for or acquire securities in a corporate body which exceed the financial limits set in paragraph 12 or otherwise have novel or contentious features because they do not or may not comply with the requirements of regularity and propriety and good financial management. BW should similarly consult the Department about any proposal to acquire an interest in an unincorporated body which exceeds the financial limits applicable to corporate bodies or otherwise has novel or contentious features because the proposed acquisition does not or may not comply with the requirements of regularity and propriety and good financial management.

Single issue tenders

14. BW shall not procure any goods or services through single issue tenders otherwise than in accordance with low value exceptions permitted under the EU Procurement Regulations. Records shall be kept of all cases where contracts are let by single tender action or otherwise departed from normal tendering arrangements and shall be made available to the Department on request.

Gifts, Awards and Prizes

16. The making of gifts, awards and prizes should be directly related to the achievement of BW's objectives. In the context of BW's commercial activities, prizes may be offered to retail customers of BW (other than employees of BW or their close associates) in connection with normal marketing practices.
17. In other circumstances BW's Chief Executive may authorise the giving of gifts of a value of not more than £300 to any persons (other than employees of BW or their close associates) where in the interests of BW and not for any improper purpose.
18. BW's Chief Executive may authorise the giving of gifts or awards to employees of BW in connection with generally acceptable employment practices (including, but not limited to, recognition of long service, incentivisation, promotion of good practice and improvement of skills and knowledge).
19. BW shall keep a record of all gifts, awards and prizes. It should include a brief description of the item, the cost, the name of the recipient and the reason for making the gift, award or prize. The record should be made available to the Department on request.
20. Gifts do not include the issue of free or complimentary copies of publications, leaflets, calendars or other such promotional material produced and distributed in large numbers. If BW is in any doubt about whether a particular item of expenditure counts as publicity or as a gift, Defra should be consulted.

Annex F

Summary of approval levels

The following table summarises the thresholds at which types of expenditure can be approved by BW unless the proposal is novel, contentious or repercussive:

Category	Threshold
Operational and non-operational projects ^{1 2} except for the purchase of property only projects and joint ventures.	£6m (Defra) £10m (HMT)
Purchase of property only	£10 m (Defra) £15 m (HMT)
Joint Ventures	£0
Single tender ¹	As per EU regulations
Disposal of properties provided conditions of Annex E.5 met	£200k
Subscription to or acquisition of securities in corporate/unincorporated bodies subject to Annex E	£250k
Compensation payments and write offs unless novel, contentious or repercussive	£2m (Defra) £5m (HMT)
Contingent Liabilities	£250K

Notes

1. The approval is for the acquisition or improvement of assets where the process is subject to open competition. Where there is no market competition the proposal must be referred to the Department for approval.
2. Where the project is subject to variation of more than 20% or the total value of the project goes over one of the approval limits it should be re-appraised and re-submitted if necessary. (See Annex I).

Annex G

OPERATIONAL PROJECT EXPENDITURE

Scope

1. This annex concerns substantial outlay (other than under section 11 TA62) that may not be carried out by BW unless it acts along lines settled with Defra in accordance with section 27(2) TA62. A project for the purposes of this Annex is a commitment to a discrete item of expenditure or to a set of expenditures related in such a way that the benefits of any one of them cannot be fully realised independently of the others. A project may not be artificially divided in order to circumvent the requirement to obtain Departmental approval.

Costs

2. The cost of a project is the total expenditure to which it would commit BW. Consultancies or reports from consultants which are directly and solely required as part of a project shall be included in the project cost. The estimated project cost shall be taken to include the value of any land with planning consent for the scheme which BW proposes to make available.

Contracts

3. Contracts shall normally be let by competitive tendering - see guidance at FM paragraph 4.10 and Annex E.

Project appraisal

4. In appraising projects, Defra looks to the BW Board to observe its duties of efficiency, economy and effectiveness in ensuring that projects receive the appropriate level of scrutiny, bearing in mind associated risks and any potential safeguards and guarantees. For information, the BW internal project assessment process is set out in Annex H.

Referral to the Department and Treasury

5. Before entering into any commitment, for projects estimated to cost more than £6m (or in the case of property only £10 m) BW shall submit an appraisal of the project to Defra - guidance on the process is at Annex I. Proposed projects estimated to cost more than £10 m (or in the case of property only £15 m) will in addition require Treasury approval.
6. Projects which are part financed by third party funding, (eg Lottery, RDA, Local Government or EU funds) will not need Departmental or Treasury approval unless BW's input of resources exceeds the £6m or £10m thresholds above.
7. Projects should be kept under regular review and specifically reviewed prior to key decision points, such as binding contracts, purchases of land to implement schemes and closing off major options, including put options.
8. If a project appears about to exceed its estimated costs when originally approved by 20% or more, it shall be reappraised and resubmitted to the Department or Treasury, as appropriate, if the Department or Treasury approved it originally; and shall be reappraised and referred to the Department or Treasury if the increase brings the costs above the thresholds in paragraph 5 above.

Research

9. BW should consult the Department about any significant changes in the direction of the research programme¹⁴.

Compliance monitoring

10. At the beginning of January and July each year BW shall submit to the Department a list of all projects involving expenditure above £500,000 (inclusive of fees) let within the previous six months. The list should indicate which, if any, of the projects was let by single tender action or where the lowest tender was not accepted. Defra will look to the relevant BW Board Committees (property and audit) for assurance that appropriate procedures are followed.

Post project evaluation

11. BW should take stock of all projects on completion to ensure that systematic weaknesses can be corrected and best practice techniques disseminated at all levels of BW. It should report to the Department on any project for which the Department saw a full appraisal. Post project analysis should be carried out on projects where outturn is 25% greater or less than estimated expenditure, or for which the final value in rental or capital terms is 25% less than estimated.

Approval levels

12. Subject to the above rules and Annex F, and assuming proposed expenditure is consistent with resources available or likely to be available to BW, BW shall be free to approve projects without reference to the Department.

¹⁴ Section 46, Transport Act 1968

Annex H

Appraisal of British Waterways Projects

As outlined above, HM Government is responsible for approving BW projects that are either (i) above the Levels of Authority (see Appendix F) or are 'novel, contentious or repercussive'.

Defra is responsible for approval of British Waterways projects in England and Wales and the Scottish Executive is responsible for approval of projects in Scotland. Other parties in Government (eg Shareholder Executive, DCLG and HM Treasury in certain cases) will also have a role to play.

Government approval is the final stage in the process and Government would expect projects to have undergone rigorous internal scrutiny and received Board approval¹⁵ prior to formal submission, as set out in Annex I.

Dependent on the scale and complexity of the project Government may require early warning that approval will be required in order to ensure the process is smooth.

Principles

There will be a single process for operational and non-operational projects within Defra's responsibility. This process will also apply to any projects of mutual interest to Defra and the Scottish Executive, with Scottish Executive officials involved throughout.

- 1) In all cases both parties (BW and Government) will seek to ensure transparency and timeliness in its dealings. However the onus is on BW (subject to market time constraints and disciplines) to give Government sufficiently early warning of the transaction so that Government and its advisers have enough time to appraise it properly. This will normally be provided once the Commercial Director Approval Stage (as set out in Annex I) has been reached.
- 2) Government's assessment of a project needs to ensure that:
 - a There is a business case demonstrating strategic fit and financial justification, showing a positive return in line with the investment strategy agreed with Government
 - b The project represents value for money
 - c The project is consistent with Government aims for BW
 - d Risks have been identified and are sufficiently managed, and
 - e All practicable options have been appraised.
- 3) British Waterways will ensure that projects comply with any other necessary requirements (eg State Aid compliance, ONS clearance, the Green Book, 'Red Book' valuation etc). Copies of documents or written assurances need to be given before approval.
- 4) Government should have access to BW's advisers when necessary.
- 5) The information that BW submits to Government should demonstrate that each of these areas has been met.

Process

BW and Defra shall agree the process whereby BW projects shall be approved. Key to ensuring that the approval process is smooth and effective will be giving Government enough

¹⁵ In exceptional cases this may be subject to final approval of specific documentation

time to respond to BW proposals. It is important that the information given to Government is clear, covers the right issues and meets the criteria set out above. Government will then seek to ensure that the principles outlined above are observed while respecting the autonomy and commercial independence of BW management. Taking these factors into account, the key steps in the approval process might include, for example:

- 1 BW gives Government early warning that a transaction is impending, giving an outline description of the project (size, rationale etc) and an indication of when approval will be required. This should be accompanied by a short paper outlining the proposal and attendant issues, bearing in mind the more detail given at this stage can help accelerate the overall process.
- 2 An initial meeting between British Waterways, UK Government and Scottish Executive (depending on the nature of the project) will discuss the issues and relate any views and concerns to BW. Following the meeting, Government will outline any preliminary concerns in writing to British Waterways including the scale and scope of work required for the formal proposal.
- 3 BW continues to work up proposal to be submitted to Government. In concurrence, additional meetings between BW, their advisers and Government parties may be necessary – depending on the size, complexity and risks associated with the project.
- 4 No less than one month prior to the approval deadline, BW should submit its draft paper to Government demonstrating the robustness of the proposal (consistent with principles set out above) and also covering points raised by Government. This will need to bear in mind the 12 days outlined below as the time required to approve any final submission. Where necessary Government can call for additional information.
- 5 Government will review BW's paper. BW and Government meet to discuss final outstanding issues if necessary. BW will prepare the final proposal.
- 6 Final submission of project proposal. Government requires a minimum of 12 working days for consideration of applications and, where Ministerial consent is required, this could be longer although in all cases Government will expedite approval. Projects requiring approval should be submitted in hard copy in their final form. Electronic versions will exceptionally be accepted for less complicated projects where deadlines are very tight. Copies should be sent, where relevant, to the necessary individuals at Defra, the Scottish Executive, DCLG, The Shareholder Executive and HM Treasury.¹⁶
- 7 Government will then come to a decision on whether or not to formally approve (with or without conditions) the proposals. The outcome of this will be communicated to BW.

¹⁶ Note: Depending on the nature and size of the project, steps 3-6 may be highly iterative and involve a number of discussions between Government and BW as well as development of BW's written proposal to Government. Alternatively, there may be no further meetings required after step 2.

Annex I

British Waterways Approval Process for Joint Ventures and Capital Investments in excess of £100,000

1. Introduction

This annex sets out the BW internal approval process for all joint ventures and capital investments in excess of £100,000.

Its objective is to ensure timely decision making, efficient use of resource, appropriate delegation and that decision makers are adequately informed on the issues appropriate to their legitimate concerns.

It is the responsibility of BW to ensure that there is an appropriate audit trail for its internal approval process.

2. BW Authority Levels Limits

	Capital investment projects	Joint ventures
Treasury	projects over £10xm (£15m for purchase of property only)	-
Defra	Projects over £6m (£10m for purchase of property only)	-
BW Board	projects above £3m	All new joint ventures/ companies .
Chief Executive with concurrence from finance director	projects £1,500,001 to £3,000,000	
Commercial Director with concurrence from Head of Property and Finance Controller Property and Ventures	projects £100,001 to £1,500,000	Investment into joint ventures/ companies within approvals given by the BW Board
General managers and Property Development Teams with concurrence from Finance manager	All projects less than £100,000	

3. Conformance with the BW investment Strategy

Conformance with the investment strategy is a key element of the capital investment approval process. The investment strategy is a BW policy document which directs the BW executive on the key attributes of its capital investment programme to meet BW's vision and portfolio development. It is updated annually and requires approval by BW Board as part of the business plan approval process. It will be provided to DEFRA annually.

The main areas covered within the investment strategy are:

- Financial hurdle rates for the different categories of project type

- Target levels of investment in the three/ four year plan between investment categories
- Non financial benefits which are deemed most desirable
- How to maximise our commercial advantage by linking to other BW activities, for example waterside expertise, public sector relationships, environment and heritage
- Fit with the Corporate plan, for example with respect to our main areas of regeneration and marketing and leisure strategy
- Risk.

4. Approval Process

a) Commercial director

The Commercial Director will exercise his approval through a recommendation from the Commercial Investment Group (CIG).

Any project with a capital value in excess of £100,000 and all joint ventures are reviewed by this group for recommendation to the relevant delegated authority.

Any proposal submitted for CIG consideration should comply with this FM and will address:

- The nature of the project and background, usually including relevant maps, drawings and photos
- How the project meets the investment strategy
- The targeted outputs (financial and non-financial)
- The level of investment required, including any elements of risk in this
- Compliance with BW's relevant operating instructions
- In the case of joint ventures, the proposed debt financing plan, appropriate evidence of its achievability and terms
- Any key planning or external funding considerations
- Any key political, public relations, heritage, environment considerations
- Alternative options considered to structure the deal differently or to undertake an alternative project, including a do nothing option
- The likely timing for the various implementation milestones and targeted outputs
- Discounted cash flow projections to show the real IRR and net present value at the appropriate hurdle rate from the investment strategy. The commercial hurdle rates set out in the investment strategy (ranging from 6% to 12% real) and the sensitivity analysis serve to provide the appropriate financial rigour required by the Treasury Green Book. These measures seek to reflect the risk of a project and obviate the need for the use of Optimism Bias.
- Identification of the major assumptions in the financial appraisal
- Sensitivity analysis showing both upside and downside scenarios on the major assumptions
- Appropriate advice or external valuations to support the major assumptions. Typically investment property acquisitions will be supported by external valuations. Larger acquisitions (over £1.5m) are usually supported by a second valuation from our property valuers to ensure the purchase price can be supported on the balance sheet. Development property acquisitions will be supported by valuations where appropriate or development appraisals
- The major risks to achieving the projected financial and non-financial outcomes and to the BW portfolio
- If the project is a joint venture proposal then the project submission will also set out the proposed partner (how selected and their capabilities); advantages and disadvantages of venturing; and the proposed level of gearing.

Submissions to the CIG will be at least three working days prior to the CIG meeting. The contents of the project submission to CIG must meet the BW relevant elements of the Green Book.

CIG may call for any other supporting material that it deems appropriate

On the basis of the submission the CIG will either accept the proposal, reject the proposal or seek further amendments to be made.

For approved projects, any amendments to the submissions made to CIG, additional material considered, minutes of the key issues raised and considered, or any conditionality for the approval, will form part of the “CIG approval papers” available for any further consideration in any subsequent layers of the approval process, or any post-project appraisal, if required.

b) Chief Executive

The Chief Executive will exercise his approval through a recommendation from the executive directors, including the concurrent approval of the Finance Director. The BW executive directors meet fortnightly. The papers submitted to the CEO will be either the “Commercial Director approval papers” or a summary of these, particularly if the project will require onward approval by the BW Board. In the latter case, the CEO can call for the “Commercial Director approval papers”. The papers will be submitted to the CEO and executive directors at least three working days prior to their meeting.

In addition to providing another layer of approval, the CEO will consider any further input from the executive directors, for these larger projects that the rationale for acquisition is sufficiently supportive of BW’s vision, and that there is strong business area integration.

On the basis of the submission the CEO will either accept the proposal, reject the proposal or seek further amendments to be made.

For approved projects, any amendments to the submissions made to CEO, additional material considered, minutes of the key issues raised and considered, or any conditionality for the approval, will form part of the “CEO approval papers” available for any further consideration in any subsequent layers of the approval process, or any post-project appraisal, if required.

c) BW Board

The BW Board will exercise its approval at a BW Board meeting, at which, at least two members of the property committee must be present. The BW Board meets approximately every two months.

The submission to the Board will be a summary of the “CEO approval papers” focusing in particular on the most pertinent issues for the BW Board:

- Rationale for the investment
- Strategic fit with the business plan, investment plan and regeneration plans
- Identification and management of risks, drawing up of a risk strategy, assessment of the impact on portfolio risk, including affordability
- Financial inputs and outcomes including project risk and sensitivity range
- Public relations and political implications

Papers will be submitted to the BW Board five working days prior to the Board meeting. On the basis of the submission the Board will either accept the proposal, reject the proposal or seek further amendments to be made.

For approved projects, any amendments to the submissions made to the Board, additional material considered, minutes of the key issues raised and considered, or any conditionality for the approval, will form part of the “Board approval papers” available for any further consideration in any subsequent layers of the approval process, or any post-project appraisal, if required.

d) DEFRA/ Treasury/ Shareholder Executive

Projects for approval by DEFRA, Treasury and Shareholder Executive will be submitted by the BW Executive to DEFRA. BW will initially provide the “Board approval papers”. DEFRA or Treasury may call for the “CEO approval papers” and/or the “CIG approval papers”.

The BW Commercial Director will be the lead BW executive for co-ordinating this process. He will ensure that DEFRA is advised of the likelihood of a project submission as soon as it has passed the Commercial Director approval stage. DEFRA may call for the “CIG approval papers” in order to accelerate understanding, identify any particular issues at an early stage, and thus facilitate the process to ensure adherence to the overall timescales.

5. Conditional and/or “in principle” approvals

All layers of this process may offer, if asked, “conditional” or “in principle” approvals, ie approvals subject to certain specified conditions, or approvals to the principle of a project subject to consideration of further specified details. The objective in seeking and granting these types approvals can greatly assist in the timely progression of any project, in particular where negotiations are needed with third parties, and assurances are needed at stages in such negotiations. When such “conditional” approvals are granted, they will be on the basis that lower layers in the approvals process confirm to the approval grantor that these conditions have been met. Where in principle approvals are granted, it will be on the basis that the grantor has a further opportunity to consider the specified details.

6. Post Project Appraisals

PPA process and approval by project type

All projects require a Post Project Appraisal (PPA) to be completed.

All full PPAs (long form) will be signed off at the most senior BW executive level of approval, as well as by the project sponsor.

Project Type	PPA text box on SAP (short form)	Full PPA (Long form)	Executive Director and Financial Controller	CEO and Finance Director
Major Works (including restoration and regeneration projects) Non Routine expenditure (GWP and small scale regeneration projects in excess of £20k, one off marketing projects regeneration etc). Operational craft, plant and equipment.	This is a minimum requirement for all projects with a planned cost of less than £100k	Required for all projects with a planned cost more than £100k . Additionally required for a project for less than £100k where the project over spent or did not achieve the anticipated output (eg less output was achieved for the money spent)	Over £250k	Over £500k
Property disposals	This is a minimum requirement for all projects with planned sale proceeds of less than £250k or exempted from long form PPA	Required for all projects with planned proceeds of more than £250k . However only a short form PPA will be required for projects where achieved proceeds were within 5% of planned value and disposal costs were within 10% of planned expenditure	Over £500k	Over £1m
Commercial expenditure (Property and Income generating projects)	This is a minimum requirement for all projects with an initial budget of less than £100k or exempted from long form PPA	Required for all projects with an initial budget more than £100k . However only a short form PPA will be required for projects if project/acquisition completed within 5% of planned costs and planned IRR achieved	Over £250k	Over £500k
Joint Ventures	Not applicable	All joint ventures	All joint ventures	All joint ventures

- Post project appraisals enable BW to discuss and disseminate any lessons learnt so that future projects are better informed.