

ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	4 December 2019
EXEMPT	No
CONFIDENTIAL	No
REPORT TITLE	Internal Audit Report AC1926 – Capital Contract Management
REPORT NUMBER	IA/AC1926
DIRECTOR	N/A
REPORT AUTHOR	David Hughes
TERMS OF REFERENCE	2.2

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the planned Internal Audit report on Capital Contract Management.

2. RECOMMENDATION

- 2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

3. BACKGROUND / MAIN ISSUES

- 3.1 Internal Audit has completed the attached report which relates to an audit of Capital Contract Management.

3.2 Management Comments

- 3.3 The audit demonstrates a strong improvement around the management and delivery of capital contracts but highlights the need to continually improve systems and processes on an ongoing basis ensuring that transparent governance arrangements continue to operate. Increased and improved reporting has also been achieved through the Capital Committee this year to ensure elected members are informed against the progress of ongoing projects. Post completion and occupation reviews will also prove key to demonstrating the effectiveness of project delivery.

4. FINANCIAL IMPLICATIONS

- 4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

7. OUTCOMES

7.1 There are no direct impacts, as a result of this report, in relation to the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place, or Enabling Technology, or on the Design Principles of the Target Operating Model.

7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Equality & Human Rights Impact Assessment	An assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
Privacy Impact Assessment	Not required
Duty of Due Regard / Fairer Scotland Duty	Not applicable

9. APPENDICES

9.1 Internal Audit report AC1926 – Capital Contract Management.

10. REPORT AUTHOR DETAILS

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Internal Audit Report

Resources

Capital Contract Management

Issued to:

Steven Whyte, Director of Resources
John Wilson, Chief Officer – Capital, Resources
Fraser Bell, Chief Officer – Governance
Jonathan Belford, Chief Officer – Finance
Roddy MacTaggart, Programme Manager
External Audit

EXECUTIVE SUMMARY

The Council manages a range of capital projects through Programme Managers, Project Boards, the Capital Board and contracted external consultants. This includes planning, preparation of Business Cases, the preparation of and invitation to tender for construction works, obtaining statutory consents, and monitoring progress via regular meetings between relevant partners.

The objective of this audit was to determine whether or not the processes in place for the management of high risk contracts are adequate and that projects are being suitably managed. This included examination of the corporate instructions for project management, data / intelligence used for monitoring and escalation of risk, and review of documentation in respect of a sample of projects including: Crematorium Refurbishment, Kingsfield Childrens Home, Stoneywood Primary School, The Event Complex Aberdeen (TECA), and Tillydrone Community Hub.

In general procedures are clear and have been followed. However, governance arrangements could be improved through clarification of levels of delegated authority and escalation procedures in the event of changes to projects' scope, costs and timescales being required. These were not always being consistently documented in advance of the changes taking place. The governance arrangements and supporting processes are currently being reviewed and updated by the Service, which has agreed to take the recommendations from Internal Audit into account.

Minor errors and omissions were identified in supporting paperwork, including dates and financial values. A new system is being rolled out to capture project data more regularly and accurately.

1. INTRODUCTION

- 1.1 The Council manages a range of capital projects through Programme Managers, Project Boards, the Capital Board and contracted external consultants. This includes planning, preparation of Business Cases, the preparation of and invitation to tender for construction works, obtaining statutory consents, and monitoring progress via regular meetings between relevant partners. The governance arrangements and supporting processes are currently being reviewed by the Service.
- 1.2 The objective of this audit was to determine whether or not the processes in place for the management of high risk contracts are adequate and that projects are being suitably managed. This included examination of the corporate instructions for project management, data / intelligence used for monitoring and escalation of risk, and review of documentation in respect of a sample of five projects:
- Crematorium Refurbishment
 - Kingsfield Childrens Home
 - Stoneywood Primary School
 - The Event Complex Aberdeen (TECA)
 - Tillydrone Community Hub
- 1.3 Detailed findings in respect of the selected sample are presented in Appendix 1.
- 1.4 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with Steven Whyte, Director of Resources, and John Wilson, Chief Officer – Capital.

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Procedures and Documentation

- 2.1.1 Written procedures which are easily accessible by all members of staff can reduce the risk of errors and inconsistency. They are beneficial for the training of current and new employees and provide management with assurance that correct and consistent instructions are available to staff, important in the event of an experienced employee being absent or leaving. They have increased importance where new systems or procedures are being introduced.
- 2.1.2 A Project Toolkit, which is available to all staff via the corporate intranet, sets out in stages how a project should be managed from inception through to completion and thereafter appraisal. The toolkit is laid out in such a manner that a user is taken through the stages from consideration of whether or not the project should proceed, the requirement for a business plan, the required authorisation, the need to ensure that proper procurement routes are undertaken, the requirement to ensure that appropriate personnel are in place and that discussions occur regularly between all groups to discuss progress and any issues. The need for appropriate planning is highlighted, as is the requirement to report progress formally, and for risks to be identified and reported to appropriate Officers and / or Committees. More detailed guidance is cross-referenced, and the requirement to seek advice from appropriate personnel is reiterated at relevant stages.
- 2.1.3 However, the toolkit is out of date, as it refers to Committees which have changed following implementation of new governance arrangements in 2018. The Service has stated that the project toolkit is in the process of being reviewed to ensure that reporting arrangements and processes are current in light of further planned reporting structure changes during 2019.
- 2.1.4 The toolkit directs users to Project Status Report templates which should be completed on a monthly basis showing spend, progress and risks. Additionally, there is a risk and issues log template which should be completed on a monthly basis.
- 2.1.5 Change requests are required in the event that any major changes to the project occur, for which a template is also provided. However, there is limited guidance on the escalation process required in the event that time, costs or project scope need to change. The requirement to ensure changes obtained relevant approvals is not included in the checklists appended to the toolkit until the 'post project evaluation' stage.

Recommendation

The Service should ensure that the toolkit is updated to cover the procedures which should be followed in the event of potential overspends and overruns.

Service Response / Action

Agreed. The process and associated guidance are in the process of being finalised for issue.

Implementation Date

December 2019

Responsible Officer

Chief Officer – Capital

Grading

Important within audited area

- 2.1.6 The Change Request Document itself includes a description of the change and an assessment of its impact on the project benefits, scope, cost and timescales. However, it does not contain a section to record the authorisation obtained. Including the source, date and extent of approval would provide at a glance assurance that the appropriate

authorisation controls are being applied. Approvals are not currently recorded in project level documentation.

Recommendation

The Service should add an authorisation section to the Change Request Document and ensure it is populated following relevant approvals being obtained.

Service Response / Action

Agreed.

Implementation Date

December 2019

Responsible Officer

Chief Officer – Capital

Grading

Important within audited area

2.2 Compliance

2.2.1 Documentation in respect of the sample of projects referred to at 1.2 above was sought and reviewed to ascertain compliance with the process in practice, including monitoring, change and escalation processes. A summary of the key findings and recommended actions is set out below. Further detail in respect of individual projects is provided in appendix 1.

2.2.2 Change requests are not always being completed in advance of changes being agreed with contractors to extend or delay works. In some cases, the request is made after actions have taken place (i.e. a delay or additional cost has already been incurred). Services have stated that requests may be delayed pending confirmation of final cost details. If change requests are to function as a control mechanism, rather than a notification, they need to be completed in advance, and approval obtained before committing to actions. This may mean seeking approval for estimated changes in advance and advising the Board of any changes to these at a later date. If projects continue without awaiting approval there is an increased risk of resources being committed in excess of those available.

2.2.3 It is acknowledged that some circumstances may lead to unavoidable delays or costs, which cannot wait for separate authorisation. The extent to which project managers, officers and groups (e.g. boards, Committees) have delegated (or reserved) authority to agree such changes is not explicitly documented. Clarifying the type and scale of changes which can be approved at each level would enhance the governance arrangements.

Recommendation

Authorisation for anticipated changes to projects costs or timescales should be sought in advance, using a project change request form.

Delegated authority to approve changes should be documented.

Service Response / Action

Agreed. Appropriate levels and the escalation process will be set out in the new guidance which is being developed by the Service. This will be supported by the new governance arrangements which are being put in place.

Implementation Date

December 2019

Responsible Officer

Chief Officer – Capital

Grading

Significant within audited area

2.2.4 Capital projects regularly include contingencies for unanticipated additional costs, variations from estimates, and provisional sums. Approval to use these is normally

obtained from the contract administrator and evidenced in the form of architects' instructions, which are provided to the contractor in advance of a change taking place. Where contingencies are likely to be exceeded project level change controls need to be applied as set out above.

- 2.2.5 Where these sums are not used towards a contract, or cost savings are obtained, expenditure on the project may be less than originally anticipated. Any underspend should be returned for wider use as part of the relevant programme and / or capital plan. In one case, an anticipated underspend has been used to extend the scope of a project, with approval from a Chief Officer without further authorisation being sought from the Capital Board. Whilst in this case the amounts were not material, there is a risk that the use of this budget towards activities not included in the original business case has not been weighed up against alternative options: other projects may not have the resources available to deliver their objectives within budget. Pooling contingency funds could assist in delivering leaner projects, however this would need to be balanced against requirements for flexibility and projects' delegated authority.

<u>Recommendation</u>		
Anticipated underspends on projects should be subject to appropriate governance before being committed to alternate works.		
<u>Service Response / Action</u>		
Agreed.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
December 2019	Chief Officer – Capital	Important within audited area

- 2.2.6 Project Status Reports provide an overview of progress and forecast outcomes for each project. Project Managers are required to complete these, and Risk and Issues logs monthly. Generally, these were well completed, however in some cases the income section (where a shortfall was anticipated), had not been fully updated to reflect known changes. For two projects there were discrepancies between the financial data recorded on the Report and that recorded in the financial system. If the records are incomplete or inaccurate it is more difficult to gauge a project's progress and obtain assurance that it is on track for completion within time and budget.

<u>Recommendation</u>		
Project documentation should be fully completed with all available information and checked against other sources of data before being finalised.		
<u>Service Response / Action</u>		
Agreed. A new system is being rolled out to complement the new procedures and governance arrangements for capital projects. As part of this an independent check will be introduced to confirm data is complete and accurate.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
December 2019	Chief Officer – Capital	Important within audited area

- 2.2.7 Client Services are the main stakeholders in capital projects and are represented by appropriate lead officers during regular project progress meetings. There is however a risk that they are insufficiently well informed when asked to make decisions regarding changes to projects – for example in weighing up options to delay a project if it could potentially generate savings, there may be insufficient information on the costs associated with doing so. Whilst project management paperwork is generally in place covering the

business case for a project, and the preferred option, once a project has started changes to it are not typically subject to the same extent of option appraisal. Whilst many options will be binary (to do or not do something) it is important that decision makers have all of the facts and are aware of the risks associated with each option before they are asked to make a decision.

Recommendation

Decisions should be supported by clear evidence and options appraisals.

Service Response / Action

Agreed. Projects are required to deliver within the agreed budget. Where appropriate and material, supporting documentation should be in place. This will be reinforced through the new guidance.

Implementation Date

December 2019

Responsible Officer

Chief Officer – Capital

Grading

Important within audited area

AUDITORS: D Hughes
C Harvey
D Henderson

Appendix 1

3. Projects (Sample)

3.1 Crematorium

- 3.1.1 Following approval of costs for the refurbishment of the Crematorium of £1.13 million by the Finance, Policy and Resources Committee as part of the Council's Condition and Suitability Programme in September 2017, a tender exercise was undertaken and a tender amount of £904,991 was accepted from the successful contractor with a start date of 4 June 2018. A consultancy firm was engaged to oversee the works and to perform regular valuations of the work undertaken prior to payments being made to the contractor.
- 3.1.2 Work commenced onsite on the intended date and there is evidence of regular meetings between the contractor, the consultancy and the Service to discuss progress with the project. Delays were identified at an early stage as a result of a previously unidentified water gully and delayed information regarding the structure, and at a later stage due to issues with audio cabling and acoustics. This delayed the completion date from 19 October 2018 to 16 November 2018. Whilst there was a change request on file dated 3 October this was only presented to the Capital Board on 21 November 2018.
- 3.1.3 As noted above these delays were identified at an early stage with Crematorium staff advised not to take bookings until the end of November. Reparations have not been sought from the Contractor as onsite drainage issues were discovered only on commencement of work and issues with electrical contractors were under the remit of the Council.
- 3.1.4 Payments to the contractor were self-billed on the advice of the consultancy following site inspections and valuation of materials and progress. Payments were correctly recorded on the financial system against the relevant project and were updated promptly on Project Status Reports.
- 3.1.5 A final statement has yet to be produced for the project, but it is expected to come in under budget. The Service has decided to rectify historical issues with the acoustics in the Crematorium by using the underspend from the initial budget. This has been discussed and approved by the Chief Officer although there is no written record of approval. While the amounts are relatively small in comparison to the overall cost of the project any authorisation to spend funds allocated to a specific project should be appropriately evidenced and should be considered in light of the impact on the overall capital programme.

3.2 Kingsfield Childrens Home

- 3.2.1 A budget of £1.5 million was set out in the non-housing capital programme presented to Council in February 2015 for the purchase and refurbishment of the children's home. Further approval was sought and obtained from the City Growth and Resources Committee in June 2018 to spend £420,000 of this budget to purchase the building from the Landlord as per the terms of the lease which allowed for the Council to purchase outright at market value following a 10 year period of leasing.
- 3.2.2 The project itself is still at an early stage following the acquisition of the building and as such a provisional project plan timeline is currently in place. Actions noted in the provisional timetable such as the final brief, National Building Specification, architectural drawings and the start of the building application process have all been completed. The Bill of Quantities, pre-tender estimate and tender quality assessments are planned to be outsourced and completed shortly. Overall the Service considers that the provisional

timetable will be largely on track. The business case will be updated as required and subject to the relevant governance arrangements.

- 3.2.3 Management of the project is to be undertaken in-house with the Service confirming that following the completion of the tender process and the start of building works, monthly meetings will be held with the successful contractor. Payments will only be made following a Quantity Surveyor's report confirming the value of work completed. Progress reporting will follow the standard project management process.

3.3 Stoneywood Primary

- 3.3.1 Following approval for the build of the new school and associated budget of £14.3 million by the Education and Children's Services Committee in June 2015, construction commenced as planned in March 2017. In order to aid monitoring and ensure completion of the project on a timely basis an external Architectural consultancy was engaged. Progress was managed by a Project Manager within Education and Children's Services supported by Aberdeen City Council Design Team and the external consultancy. Progress was additionally monitored by the Asset Board and Estates Programme Manager. Regular monthly meetings between the Service, the Architectural consultancy and the Construction company were evidenced in which progress and any issues arising were noted as being discussed. Payments to the Construction company were only made following advice from the Architectural Consultancy. Project Status Reports have been completed on a monthly basis.

- 3.3.2 Expenditure noted on Project Status Reports each month should match the information which is recorded on the financial system. Anomalies were noted across 7 months with the year-end expenditure for 2018/19 on the Project Status Reports showing £1.905 million, compared with financial system totals of £1.864 million.

- 3.3.3 The cost of construction and subsequent value of the tender award to the Contractor was noted as being £11.268 million. The cost of the building works to date has increased by £634,000 to £11.902 million. This increase is due to a combination of factors including having to amend the planning application to relocate the school entrance in May 2017 at a cost of £370,000 and installation of a crossing, upgrading of bus shelters and traffic management measures at the same time at a further cost of £110,000. A change request form noting these amendments was completed at this time with the Service stating that this was approved by the Capital Board.

- 3.3.4 It was noted that the Contractor had advised in September 2017 that the project was likely to overrun by 12 weeks and this was advised on a change request form promptly thereafter. Following discussion between parties an extension of 6 weeks was granted (as noted on a further change request form) with the financial implications of this being a further increase in the cost of the contract by £154,000. This cost was to be absorbed by the Service within the available budget for the project (i.e. from funds held for contingencies).

- 3.3.5 The Service noted that the accepted tender from the Contractor stated that it may be possible to realise savings of up to £800,000 by moving to a timber frame method of construction. The client Service was asked if it would like to further investigate this option in order to assess the potential cost savings and accept any delays that this could cause. The cost implications of investigation and delay were not clarified at this point. The Architectural Consultancy then investigated and presented different options in relation to construction and established that the cost savings would be £135,000. The Architect advised that investigative and redesign work to realise this saving had cost £65,000 meaning that the actual realised savings were only £70,000. This saving is likely to have been further diminished by the cost of time delays as noted above.

- 3.3.6 'Value engineering' is regularly used to reduce the cost of construction through approval of the use of alternate materials or methods where appropriate. As a significant element of the construction costs, the structure of the building was originally set by the Council in the invitation to tender documentation. Bids were therefore received on the basis of a particular building type and construction. Changes after the contract was awarded to make this a contractor designed element of the works could be seen by other bidders for the original contract as a fundamental change (beyond value engineering), for which they had not been afforded the opportunity to offer alternative bids. However, as noted above this was not taken forward after review of the proposed options.
- 3.3.7 As noted above the total budgeted cost of the project was £14.3 million. The April 2019 Project Status Report noted that this was likely to increase by a further £266,000 to £14.566 million due to construction costs, although the final cost is currently unknown and the Service has stated that a further change request form will be completed once the total costs have been established. Whilst there may be uncertainty regarding the exact figures, it is important that agreement is obtained in advance to changes which are likely to exceed the available budget, in order that appropriate arrangements can be made to mitigate them.
- 3.3.8 Of the £14.3 million budget for the project, £4.066 million was to come from external sources. It has been noted on Project Status Reports that £991,000 of developer obligation funding included in the original budget will not be available. While this is noted within the comments section of the Reports, the income section has not been updated to reflect the anticipated shortfall. To date only £307,000 of income has been applied to the project. Some sources of funding, including developer obligations, are time limited, therefore the Service needs to ensure they are applied promptly, and reflected appropriately in Project Status Reports as the project progresses to highlight if there are any associated risks to their achievement.

3.4 The Event Complex Aberdeen

- 3.4.1 In March 2015, Council approval was given for the business case for a replacement for the Aberdeen Exhibition & Conference Centre (AECC): The Event Complex Aberdeen, hereafter referred to as TECA. The cost of the project was estimated to be £383.12 million.
- 3.4.2 Overall responsibility for the running of the project and associated budget which includes the new arena, 2 hotels, an integrated energy centre, and a gas to grid project was allocated to a newly formed AECC Project Board. This Board is accountable to the Corporate Management Team to whom they submit reports who in turn submit any appropriate reports to Committee. The AECC Board is supported by a Delivery Group which manages meetings and submits various reports to the Board for consideration.
- 3.4.3 The Service has engaged the services of a Project Management Consultancy to monitor the project including the financial aspect and they were to provide monthly updates on progress. The Council's Development Partner for the project has employed an Employers Agent and Cost Control Consultant to monitor the Contractors costs and these costs are evaluated by the Project Management Consultancy before any instruction is given to the Council to pay any instalments. The Project Management Consultancy have their own spend profile which they compare to the Contractor's original spend profile. Monthly meetings were to be held between all parties to discuss progress and any issues which may have arisen.
- 3.4.4 There is evidence of monthly meetings showing construction progress which contain financial progress updates and updated forecasts. PSRs are also completed every month with separate reports being generated from these which are presented to the Strategic Asset & Capital Board highlighting issues which have been flagged as either amber or red

(in terms of their progress and / or financial implications). Payment certificates were also present showing payments made to contractors.

3.4.5 A report presented to the Capital Programme Committee on 3 June 2019 provided an overview of the project progress to date noting that construction had started in June 2016 with an expected build time of 3 years. Project milestones noted as having been achieved during this period included structural, mechanical, electrical works and interior finishing of the building. The project is expected to be handed over in stages starting in May 2019 and concluding in August 2019. The Gas to Grid project is expected to be complete in December 2019.

3.4.6 The total net budget for the project was £383.12 million of which, according to the above report, £325.96 million had been spent so far. The Committee report only reflected the construction phase of the project and the total cost of the project is yet to be fully calculated with the report noting that a full financial outturn will be provided by the Chief Officer – Capital as part of the post project evaluation procedure – no forecast was provided in the report. As with other projects, costs need to be forecast and approval sought for changes in advance, before projects are concluded and evaluated.

3.5 Tillydrone Community Hub

3.5.1 This project is comprised of 2 parts, the first being the construction of the Tillydrone Community Hub and the second relating to the development of a commercial retail unit to be let. The Internal Audit review concentrated on the first part of the development as the second part has yet to commence and changes are anticipated which have yet to be fully detailed and agreed.

3.5.2 Funding for both elements of the project was estimated at a total cost of £6 million of which £4.1 million was to be funded by the Council and the remaining £1.9 million was to be provided by a Scottish Government grant for construction costs between October 2017 and March 2018. Delays to the start of the construction process however led to a change request being submitted to change the terms of the grant. Scottish Government agreement was evidenced and the grant income was received following award of the tender to the successful contractor.

3.5.3 Construction commenced in March 2018 following delays, for which a change request form was completed to extend the anticipated completion date from October 2018 to March 2019. Following commencement of the project there have been monthly minuted meetings between the contractor, the consultancy employed to assist with delivery of the project and the Service in which construction progress was discussed in detail.

3.5.4 The completion date for the project has been further extended by 2 months following the loss of 41 days construction time for inclement weather and a sub-contractor entering administration necessitating the appointment of a replacement. The minutes show that these problems were identified at the time they arose in March 2019, however a change request to extend the due date for construction was not submitted until June 2019.

3.5.5 The Service has employed a consultancy firm who inspect the site on a regular basis before advising the Service as to what payment should be made every month taking into account the value of materials onsite and the work performed. Monthly reports are comprehensive and payment certificates matched the amounts due.

3.5.6 Project Status Reports have been completed monthly. However, anomalies were noted across 4 months with the 2018/19 year-end total showing £2.647 million, compared with details from the financial system which showed expenditure of £2.595 million. A further error was noted on the May 2019 report which showed spend of £162,000, compared with

financial system data which presents a credit balance of £226,000, due to an accrual not having been taken into account.

- 3.5.7 Spend for the project is noted as being in line with forecast, although the Service has stated that there may be an underspend dependent on the options agreed in relation to the second part of the project.

Appendix 2 – Grading of Recommendations

GRADE	DEFINITION
Major at a Corporate Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the Council.
Major at a Service Level	<p>The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited.</p> <p>Financial Regulations have been consistently breached.</p>
Significant within audited area	<p>Addressing this issue will enhance internal controls.</p> <p>An element of control is missing or only partial in nature.</p> <p>The existence of the weakness identified has an impact on a system's adequacy and effectiveness.</p> <p>Financial Regulations have been breached.</p>
Important within audited area	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.