

ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	22 February 2018
REPORT TITLE	Internal Audit Report AC1819 – Capital Contracts
REPORT NUMBER	IA/AC1819
LEAD OFFICER	David Hughes
AUTHOR	David Hughes

1. PURPOSE OF REPORT

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

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 Contracts.

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. IMPACT SECTION

7.1 **Economy** – The proposals in this report have no direct impact on the local economy.

7.2 **People** – There will be no differential impact, as a result of the proposals in this report, on people with protected characteristics. An equality impact 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. The proposals in this report will have no impact on improving the staff experience.

7.3 **Place** – The proposals in this report have no direct impact on the environment or how people friendly the place is.

7.4 **Technology** – The proposals in this report do not further advance technology for the improvement of public services and / or the City as a whole.

8. APPENDICES

8.1 Internal Audit report AC1819 – Capital Contracts.

9. REPORT AUTHOR DETAILS

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ABERDEEN

CITY COUNCIL

Internal Audit Report

Communities, Housing and Infrastructure

Land and Property Assets

Capital Contracts

Issued to:

Bernadette Marjoram, Interim Director of CH&I & Chair of Capital Board

John Quinn, Head of Land and Property Assets

Fraser Bell, Head of Legal & Democratic Services

Steven Whyte, Director of Resources

Craig Innes, Head of Commercial and Procurement Services

Arthur Barrie, Principal Quantity Surveyor, Land & Property Assets

Simon McKenzie, Quantity Surveyor, Land & Property Assets

External Audit

EXECUTIVE SUMMARY

Aberdeen City Council Land & Property Assets builds, manages, and maintains the Council's property portfolio. This includes planning, procurement and management of capital building projects on behalf of client services.

The Capital Contracts budget for 2017/18 includes a £55 million Housing Capital Programme, and £11 million of Non-Housing Capital Projects under a Condition & Suitability Programme. Within these programmes Building Projects and Capital Works are developed over more than one financial year.

The objective of this audit was to ensure appropriate arrangements are in place regarding the tendering for and monitoring of a sample of Capital Contracts and value for money is being obtained. Corporate procurement regulations are in place to promote compliance with public sector procurement rules, and in general these are being followed, though service specific procedures require to be updated and minor errors and omissions in supporting paperwork were identified. The Service is updating procedures and will ensure documentation is complete and retained on file.

A proportion of the Council's procurement regulations are however being set aside annually, with approval from Full Council, without compensating controls. The Service has agreed to work with Commercial and Procurement Services to provide the most appropriate manner to ensure that, whilst delivering an extensive and fluid programme of works for its housing stock, it is not exempt from Procurement Regulations.

From the sample reviewed, tenders were often in excess of the original estimate by the Service, and limited numbers of bids were received. Although these are open tenders, fewer bidders could affect the ability of the Service to demonstrate that it is obtaining value for money. The Service has agreed to review estimating and scheduling techniques to ensure it can demonstrate that best value is being achieved.

Additional works due to unforeseen circumstances are being agreed with contractors through formal Architects Instructions, and monitored via monthly cost reports, but these are not all being costed in advance, and where variations are in excess of officer delegated limits (the lesser of 25% or £100,000) there is currently no mechanism to seek Committee approval. The Service considers that this element of the corporate procurement regulations does not reflect the requirements of capital contracts and will seek delegated authority to approve such variations.

1. INTRODUCTION

- 1.1 Aberdeen City Council Land & Property Assets builds, manages, and maintains the Council's property portfolio. This includes planning, procurement and management of capital building projects on behalf of client services.
- 1.2 The Capital Contracts budget for 2017/18 includes a £55 million Housing Capital Programme, and £11 million of Non-Housing Capital Projects under a Condition & Suitability Programme. Within these programmes Building Projects and Capital Works are developed over more than one financial year.
- 1.3 The objective of this audit was to ensure appropriate arrangements are in place regarding the tendering for and monitoring of a sample of Capital Contracts and value for money is being obtained. A review was therefore undertaken to ensure that adequate control is exercised over Property Capital Projects in respect of project planning, contract tendering, committee reporting, project spend and project monitoring.
- 1.4 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with John Quinn, Head of Land and Property Assets, Arthur Barrie, Principal Quantity Surveyor, Simon McKenzie, Quantity Surveyor, and Alison Gallacher, Procurement Category Manager.

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Procedures

- 2.1.1 Written procedures are an essential part of any system. They provide a reference point for staff and give management assurances of control. Without adequate documented procedures, a system may not be able to function correctly, particularly when key members of staff are absent.
- 2.1.2 The Public Buildings Team were aware that procedures required to be updated, some of which were still in draft and not yet issued to staff. Whilst key processes are in place and will remain similar regarding the tendering process, changes to corporate procurement guidance need to be reflected in updates. The Housing Team had no documented procedures, and intends to amend and then implement the Public Buildings Team procedures to suit when available. A recommendation has been made to track progress.

Recommendation

The Service should ensure procedures are updated to reflect Corporate Procurement Guidance and circulated to staff.

Service Response / Action

Agreed. Procedures are being updated and will be rolled out.

Implementation Date

December 2018

Responsible Officer

Principal Quantity
Surveyor / Team Leader
(Design)

Grading

Important within audited
area

2.2 Committee Reporting

- 2.2.1 The Council's Non-Housing Condition & Suitability 3 Year Programme 2016/17 to 2018/19 (£26 million) was approved at the Finance Policy & Resources Committee on 20 September 2016, and again on 20 September 2017, and authority was delegated to the Head of Land & Property Assets, in consultation with the Strategic Asset & Capital Board and the Convener and Vice Convener of the Committee, to amend the Programme and to allocate projects or additional budgets to/from a £500,000 contingency fund should priorities change due to unforeseen circumstances during the year, with such changes to be reported to the Committee.
- 2.2.2 Authority was also obtained to undertake tendering procedures and award contracts thereafter, without having to first refer to Committee with an expenditure estimate as required under the Council's Procurement Regulations. However, as changes and budgetary implications are being reported periodically to the Committee in respect of the delegated authority to amend the Programme, there is still Committee oversight of the Service's plans and budgetary implications.
- 2.2.3 The Housing Capital Programme Budget for 2017/18 (£55 million) was authorised at a high level as part of the Council's budget setting meeting on 22 February 2017. The Service sought approval of a budget for each element of the programme but not estimates of each individual project contained therein (see examples in Appendix 2). As in previous years, and similar to the Non-Housing Condition & Suitability Programme, an exemption was sought and granted by the Council to allow the allocation of contracts to the Housing Capital Programme budget without the need for further authorisation.
- 2.2.4 This is in direct contrast to the Council's Procurement Regulations which state that "*No tender shall be invited or contract entered into unless the total estimated expenditure has*

been previously approved. The allocation of a budget as part of the Council's budget setting process is insufficient." The method of authorising a works procurement is normally dependent on the Contract Value (e.g. below £250,000 by Head of Service and above £250,000 only with Committee approval). Committee reports are also ordinarily required for extensions to contracts or costs which vary in excess of the estimates originally reported to Committee by the lesser of 25% or £100,000.

- 2.2.5 As this Programme has been exempted from these requirements, and no other requirements have been instated (in contrast to the Non-Housing Condition & Suitability Programme) there is limited further reporting to Committee and therefore no guarantee that the operational and financial outcomes will reflect the Committee's original expectations. In addition, there is a risk that having one Service continued to be exempt from Procurement Regulations might set a precedent for others. If there is a requirement for an alternative approach for Land & Property Assets it would be better to have an exemption incorporated within the Procurement Regulations, with compensating controls, than asking for the Regulations to be set aside in full each year.

Recommendation

The Service, in consultation with Commercial & Procurement Services, should ensure there is sufficient transparency over all cost estimates, variations, and decisions to procure.

Service Response / Action

Agreed. The Service will work with Commercial and Procurement Services to provide the most appropriate manner to ensure that, whilst delivering an extensive and fluid programme of works for its housing stock, it is not exempt from Procurement Regulations.

In order to increase transparency it was agreed in 2017 that additional data on the number of properties per Ward being improved under each line of the capital plan would be included in future committee reports. This will commence in April 2018.

In addition, where variations in programme costs are identified, management change control processes are in place, and where variations can be resolved through virement from another line on the capital plan this is reported accordingly.

Implementation Date

April 2019

Responsible Officer

Chief Officer - Capital

Grading

Significant within audited area

2.3 Capital Plan

- 2.3.1 Revised Capital Plan processes involving the Programme Management Office have recently been implemented for Land & Property Assets, with the intention that these will develop and improve incrementally. Project Status Reports are being produced for projects in the Housing Capital Programme and for Non-Housing Capital Projects under the heading Condition & Suitability Programme, highlighting the total spend to date, any current due dates and where needed any associated risk factors, under a red, amber or green flag. From these, Project Dashboards are prepared and produced to the Strategic Capital Board and the Corporate Management Team.

- 2.3.2 The Project Status Reports do not however always give details of the individual projects within the Housing Capital / Condition & Suitability Programmes, making it difficult for the reader to determine whether individual projects remain on target, and on budget. Readers cannot therefore assess for themselves whether all of the risks have been identified and addressed.

Recommendation

The Service should work with the Programme Management Office to ensure Project Status Reports provide sufficient transparent detail.

Service Response / Action

Agreed. Reports are being developed iteratively in discussion with the PMO. There have been difficulties reconciling the approach with the requirements of work programmes, which continue to be discussed. There are insufficient resources to complete Reports for every project, however major contracts have been identified and are being included in separate reports for management.

Implementation Date

Ongoing

Responsible Officer

Principal Quantity
Surveyor / Team Leader
(Design) / Budget Holders

Grading

Important within audited
area

2.4 Tendering

- 2.4.1 Quantity Surveyors are responsible for ensuring that, from start to finish, projects are delivered in accordance with financial regulations, procurement legislation and industry standards.
- 2.4.2 A Design Team Request for Services Form is used by the Non-Housing Team and a Project Initiation Form is used by the Housing Team at the start of each project. Both are completed with a Project Number and financial codes.
- 2.4.3 If Building Services cannot carry out the work, the Quantity Surveyor will decide whether to use the Quick Quote System or Tender via the Public Contract Scotland Website and prepare the appropriate paperwork.
- 2.4.4 Tender opportunities are advertised on the Public Contracts Scotland Website. After the deadline, the tenderers' submitted documents will be checked, scored accordingly and recorded on a tender scoring matrix.
- 2.4.5 Authorisation will then be sought from the budget holder to award the contract to the bidder with the highest score. The winning bidder is then sent an acceptance award letter signed by the Head of Service, to be returned signed by the Contractor.
- 2.4.6 The Quantity Surveyor will complete a Contract Award Notice on the Public Contracts Scotland Website, and a Contract Registration Form which is sent to Commercial & Procurement Services to add the contract to the BOrganised Contract Register.
- 2.4.7 8 Capital Contracts were selected for analysis to ensure that adequate controls were exercised and that the above processes were followed. A small number of minor issues in respect of completion and retention of relevant paperwork were highlighted, including:
- 2.4.8 For Housing Contracts there was 1 instance where the winning bidder amount was wrongly marked on the tender scoring matrix (though this had no impact on the award).
- 2.4.9 For Non-Housing Contracts there was 1 instance where the tender report had the wrong date noted. There was no signed Tender Evaluation Matrix in 3 instances and 1 instance where the email to the budget holder could not be found.
- 2.4.10 There were also 3 instances where the contractor had not returned the acceptance letter signed.

Recommendation

The Service should ensure supporting records for tender exercises are complete and retained on file.

Service Response / Action

Agreed.

Implementation Date

Implemented

Responsible Officer

Principal Quantity
Surveyor / Quantity
Surveyor (Public
Buildings)

Grading

Important within audited
area

2.4.11 Contract Award Notices must be published on the Public Contracts Scotland Website within 30 days to be compliant with the Procurement (Scotland) Regulations 2016. There were 3 instances where Housing contract award notices were not published within this timescale (50 days, 168 days and 190 days.)

Contract	Awarded	Notice to Procurement	Published
H1242	2 March 2017	2 March 2017	16 August 2017
H1251	4 April 2017	23 May 2017	16 August 2017
H1176	18 May 2017	24 November 2017	23 November 2017

Recommendation

The Service should ensure Contract Award Notices are sent to Commercial & Procurement Services (CPS) in order for CPS to publish within 30 days of award.

CPS should ensure award notices are published promptly following notice from Services.

Service Response / Action

Agreed.

Implementation Date

Implemented

Responsible Officer

Principal Quantity
Surveyor;
Quantity Surveyor (Public
Buildings);
Procurement Category
Manager

Grading

Significant within audited
area

2.4.12 In 6 of 8 cases reviewed tenders were received in excess of the original estimate / anticipated value of works placed on the Public Contracts Scotland website (see appendix 2). This indicates that estimations are not always aligned with the market. In addition, in 5 cases, fewer than 4 bids were received. Although these are open tenders, fewer bidders could affect the ability of the Service to demonstrate that it is obtaining value for money. There is a risk that programmes may be over-committed, or that the timing of works is not being scheduled to take market conditions into account.

Recommendation

The Service should review estimating and scheduling to ensure it can demonstrate that best value is being achieved.

Service Response / Action

Agreed.

<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
April 2019	Chief Officer - Capital	Significant within audited area

2.5 Project Monitoring and Expenditure

- 2.5.1 The same 8 Capital Projects were also tested to ensure that there was adequate monitoring of project progress, that financial spend reflected estimates and clear explanations were given for any variances.
- 2.5.2 Before a payment is made a valuation is done by a Quantity Surveyor (which may be external). After checking the valuation a Self-Billing Invoice and Payment Certificate is prepared along with a Payment Voucher which is then sent to accounts payables for payment.
- 2.5.3 40 Self Billing Capital Project Payments between April 2017 and November 2017 were analysed. All had the appropriate completed paperwork, authorised correctly, and which clearly reflected the payments made. The correct retentions were applied, the correct payments were made and the correct financial codes were applied.
- 2.5.4 For each project there are clear statements showing that additions, deductions and revisions to contracts had been made, and approved by the Quantity Surveyors or Architects. Architects Instructions are used to formally agree any changes to the originally tendered and contracted Bills of Quantities devised by the Quantity Surveyors originally estimating the requirements of each contract, considered necessary due to unforeseen requirements arising during the course of planned works. Although used as a change control mechanism, and there are columns on the pro-forma for approximate cost additions and deductions, the Instructions are not all costed in advance. Whilst it will be possible to determine whether value for money has been obtained after the work has been done, with reference to other rates and prices set in the contract and professional judgement, and measurement of works prior to payment being made, these Instructions could materially impact on the scope of the works, altering the terms and value of a contract.

Recommendation

The Service should ensure an estimated cost is included on Architects Instructions in advance of changes to works being instructed.

Service Response / Action

Agreed. Use of contingencies and provisional sums within contracts is delegated to the contract administrator. Additional works due to unforeseen circumstances are considered by Architects and Quantity Surveyors prior to issuing instructions, and this will be recorded more consistently in future. The actual cost is monitored via monthly cost reports.

Implementation Date

April 2018

Responsible Officer

Principal Quantity
Surveyor / Quantity
Surveyor (Public
Buildings)

Grading

Significant within audited
area

- 2.5.5 As noted above at 2.2.4, variations to contract expenditure in excess of the lesser of 25% or £100,000 must be reported to Committee. However, in one case (H1182) October 2017 cost reports indicated an additional £173,000 of additional works had been required to date. In another (H1242) November 2017 cost reports indicated that £162,000 of additional work (on a £514,000 contract) was awarded to add further properties into an

upgrade contract, and to address unforeseen circumstances. The latter was partly offset by deductions for items varied and contingencies used, resulting in a net additional cost of £94,000. There is a risk that these contracts will exceed the delegated limit of £100,000.

Recommendation

The Service should ensure relevant approvals have been granted before revising contracts in excess of 25% or £100,000.

Service Response / Action

The Service considers that this element of the procurement regulations does not reflect the requirements of the Service's capital contracts, as strict application would reduce flexibility to apply professional judgement, and delays would result in additional cost. A contractor on site offers value for money due to reduced costs of mobilisation and pre-agreed rates for work. The Service will seek delegated authority to approve such variations.

Implementation Date

October 2018

Responsible Officer

Chief Officer – Capital

Grading

Significant within audited area

AUDITORS: D Hughes
C Harvey
J Galloway

Appendix 1 – 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.

Appendix 2 – Sample details

Contract	Estimate / Budget per Capital Plan	Approximate Contract Works Value on PCS	Selected Tender Bid Amount	Final Valuation / Most Recent Estimate
Housing:	From HRA Capital Plan agreed by Full Council as part of HRA budget setting process 16 December 2015 and 22 February 2017			
H1182 Manor Walk New build Housing.	New Build Housing: £23,275,000 for 2 schemes.	£10,000,000 (Second scheme £15,000,000)	£13,528,499 (Second scheme £12,183,925)	£13,370,463
H1242 BISF Houses External Insulation	Solid Wall Insulation: £500,000 per annum 2017/18 – 2020/21, revised to £1,300,000 in 2017/18, £2,500,000 in 2018/19 and £1,000,000 per annum to 2021/22. Individual projects not detailed.	£300,000 to £400,000	£514,400	£608,366
H1251 Sheltered Housing Boiler Replacement	Energy Efficiency Sheltered: £0 per annum 2016/17 – 2020/21	£143,519 to £252,556	£145,082	£153,364
H1176 Girdleness Fabric Repairs	Structural Repairs General Housing: £2,000,000 for 2017/18, revised to £3,400,000 then £2,000,000 per annum to 2020/21. Individual projects not detailed.	£250,000 to £350,000	£390,787	£373,135
H1219 Rosehill Court Roof Replacement	Upgrade Flat Roofs – Multi Storey: £1,572,000 for 2017/18, revised to £2,400,000. Individual projects not detailed.	£350,000 to £450,000	£537,240	Not yet complete
Non-Housing:	Condition & Suitability Programme agreed by Finance, Policy & Resources Committee 20 September 2016 and 20 September 2017			
7532 Cornhill Primary School Kitchen Refurbishment	No separately identified kitchen project for this school.	£200,000	£322,048	£326,537
7606 Abbotswell Primary Early Years Provision	Not included in the Condition & Suitability Programme	£200,000	£164,350	£130,915
7389 Tullos School Roof Works & External Repairs	£100,000	£225,000 to £250,000	£275,000	£253,245