

ARGYLL & BUTE COUNCIL

Internal Audit Section

INTERNAL AUDIT REPORT

CUSTOMER DEPARTMENT	CUSTOMER SERVICES
AUDIT DESCRIPTION	RISK BASED AUDIT
AUDIT TITLE	HUB NORTH MODEL
AUDIT DATE	JULY 2016

2016/2017



1. BACKGROUND

This report has been prepared as a result of the Internal Audit review of the Hub North project within Customer Services as part of the 2016/17 Internal Audit programme.

As part of the Scottish Schools for Future Program (SSF) hub North Scotland Limited were appointed in March 2016 to deliver 2 new secondary schools by the spring of 2018, namely Oban High School at a capital cost of £34.8m and Campbeltown Grammar School at a cost of £21.8m. Hub North Scotland comprises of Alba Community Partnerships (a joint venture of Galliford Try Investments, Equitix and Sweet Investment Services), Scottish Futures Trust and 16 Northern Territory Partners, working with local suppliers and contractors to deliver quality buildings and services. Hub North has responsibility for the Design, Build, Finance and Maintain (DBFM) project.

Construction began on replacing both Oban High School and Campbeltown Grammar School in June 2016. The new Oban High School has a design capacity of 1,300 pupils and a Gross Internal Floor Area (GIFA) of 13,770 m² which incorporates additional accommodation for young people with additional support needs, vocational education and partnership working totaling 1,215 m². The new Campbeltown Grammar School has a design capacity of 500 pupils and a GIFA of 7,313 m² which incorporates additional accommodation for young people with additional support needs, vocational education and partnership working totaling 888 m².

The Scottish Government is providing revenue support for projects within its SSF programme. The Council has agreed a funding provision for both capital and revenue for the school redevelopment projects. Following the adoption of the European System of Accounts 10 (ESA10) by the Scottish Government, Local Authorities that had previously planned to make capital contributions to DBFM schools projects are no longer be able to do so. The project will instead be financed via contributions (Unitary Charge) from both the Scottish Government and the Council over a 25 year period. The Unitary Charge (UC) also covers Lifecycle and Facility Management costs.

A requirement of the funding is that the Council adheres to the Hub procurement route. Hub North have adopted a Superblock Secondary School design which is intended to meet the Scottish Government's requirement in relation to cost per square metre and to square metre per child. In addition, the proposed design is expected to achieve savings in both Life Cycle Maintenance and Facility Management costs.

The audit will focus on both Cambeltown Grammar School and Oban High School.

2. AUDIT SCOPE AND OBJECTIVES

- Review Governance arrangements
- Review Monitoring Procedures and reporting arrangements
- Review financial management arrangements including modelling, budgeting and general controls
- Risks have been identified and mitigated against and escalation protocols reviewed

Controls will include:

Authority –	Roles and delegated responsibilities are documented in policies and procedures
Occurrence –	Sufficient documentation exists to evidence procedures
Completeness –	Policies and procedures are aligned to contractual agreements in place
Measurement –	Risks registers are in place and regularly updated and mitigation actions are in place
Timeliness –	Policies and procedures are regularly reviewed and updated as necessary
Regularity –	Documentation is complete, accurate and not excessive; it is stored securely and made available only to appropriate members of staff.

3. RISKS CONSIDERED

- Reputational risk to Council of non-delivery of projects;
- Inadequate monitoring of projects;
- Inadequate governance arrangements;
- Failure to report progress and performance.
- Financial cost overruns

4. AUDIT OPINION

The level of assurance given for this report is Substantial

Level of Assurance	Reason for the level of Assurance given
High	Internal Control, Governance and the Management of Risk are at a high standard with only marginal elements of residual risk, which are either being accepted or dealt with. A sound system of control is in place designed to achieve the system objectives and the controls are being consistently applied.
Substantial	Internal Control, Governance and management of risk is sound, however, there are minor areas of weakness which put some system objectives at risk and where specific elements of residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.
Reasonable	Internal Control, Governance and management of risk are broadly reliable, however although not displaying a general trend there are a number of areas of concern which have been identified where elements of residual risk or weakness with some of the controls may put some of the system objectives at risk.
Limited	Internal Control, Governance and the management of risk are displaying a general trend of unacceptable residual risk above an acceptable level and system objectives are at risk. Weakness must be addressed with a reasonable timescale with management allocating appropriate resources to the issues raised.
No Assurance	Internal Control, Governance and management of risk is poor, significant residual risk exists and/ or significant non-compliance with basic controls leaves the system open to error, loss or abuse. Residual risk must be addressed immediately with management allocating appropriate resources to the issues.

This framework for internal audit ratings has been developed and agreed with Council management for prioritising internal audit findings according to their relative significance depending on their impact to the process. The individual internal audit findings contained in this report have been discussed and rated with management.

A system of grading audit findings, which have resulted in an action, has been adopted in order that the significance of the findings can be ascertained. Each finding is classified as High, Medium or Low. The definitions of each classification are set out below:-

High - major observations on high level controls and other important internal controls. Significant matters relating to factors critical to the success of the objectives of the system. The weakness may therefore give rise to loss or error;

Medium - observations on less important internal controls, improvements to the efficiency and effectiveness of controls which will assist in meeting the objectives of the system and items which could be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified;

Low - minor recommendations to improve the efficiency and effectiveness of controls, one-off items subsequently corrected. The weakness does not appear to affect the ability of the system to meet its objectives in any significant way.

5. FINDINGS

The following findings were generated by the audit:

Review Governance arrangements

Governance arrangements for hub North were agreed at 25th April 2013 and include;

- The procuring body (Argyll and Bute Council) is required to have in place a dedicated, qualified and sufficiently resourced project team to lead delivery of the projects.
- The procuring body is required to have in place a Senior Responsible Officer (SRO) and also Project Director with recognised experience in project management and delivering revenue financed projects.
- The procuring body is required to put in place a project governance structure, clearly linked to the governance arrangements of the organisation, which will ensure effective oversight and scrutiny at a senior level.
- The project will be required to go through Key Stage Review and Post Project Evaluation, as directed by the Scottish Government, through the development phase until Financial Close is reached. The review process should be undertaken in full from the earliest applicable milestone. Successful completion of each Key Stage Review is required in order for the project to proceed to the next stage of delivery.

The following findings were noted re the above:

- Argyll and Bute Council have assigned a project team covering various disciplines including Project Management, Financial, Architecture and Administrative experience. With regards to the requirement of project experience it was noted that the principal members of the project team had been involved in the delivery of the Non Profit Distributing Organisation (NPDO) project.
- The Council has authorised the former Executive Director of Community Services to act as the Senior Responsible Officer (SRO) and he will be responsible for reporting directly to the Council. It was noted that the former Executive Director has recently been appointed as Chief Executive of Argyll and Bute Council but remains as the SRO. It was evidenced that the position of Project Director has been assigned.
- A project Governance structure has been put in place. The Council meeting of 24th April 2014 agreed that “All matters in respect of the new school provision for Oban High School and Campbeltown Grammar School be delegated to the Policy and Resources Committee (P&R).” The SRO will be responsible for reporting to the P&R Committee and updating the Strategic Management Team (SMT). Reporting directly to the SRO will be both the Project Director and Project Manager.
- It was evidenced that the Key Stage Review in regard to pre stage 2, i.e. agreed design and costs, has been completed and signed off by the SRO and had also been approved by the P&R committee on 17th March 2016. It was noted that this document sets out the key roles within the project.

It was evidenced from review of documentation that the responsibilities of key personnel have been detailed however it was noted that documentation differs from the Key Stage Review document in regard to the role of Project Manager. The Project Manager position mentioned in the Key Stage Review has been removed and the Project Director position is now assigned to 2 personnel.

It was evidenced from the Council meeting of 24th April 2014 that the following was agreed:

- All matters in respect of the new school provision for Oban High School and Campbeltown Grammar School should be delegated to the P&R Committee.

- Capital and Revenue budgets for both Oban High school and Campbeltown Grammar School.
- The design capacity for Oban High School and Campbeltown Grammar School as 1,300 and 500 respectively, in terms of the Education base case
- Authorise the Executive Director of Community Services to issue the New Project Request (NPR) on the basis of the agreed design capacities

Review Monitoring Procedures and Reporting arrangements

- It was noted that construction of both Oban High School and Campbeltown Grammar School began in June 2016.
- It was evidenced that a reporting schedule has been prepared which sets the monitoring arrangements in place to cover the construction phase of the projects. The schedule covers the following reporting areas;

<u>Meeting with/ Report from</u>	<u>Detail of Report</u>	<u>Frequency of Report</u>	<u>Evidence</u>
Site progress meetings	Reports from Morrison's as Construction contractor	Monthly	Agreed to report for May and June 2016
Hub progress reports	Formal reporting on progress	Monthly	Agreed to slide presentation - May 2016
Consultants progress reports	Report gives an independent view of site progress. Formal	Monthly	Evidenced the Monthly meeting/report

<u>Meeting with/ Report from</u>	<u>Detail of Report</u>	<u>Frequency of Report</u>	<u>Evidence</u>
	reporting on progress		
ABC Team- construction monitoring	Site Visits	Weekly	Evidenced weekly reports from Argyll and Bute Architect on construction visits
A&BC Project Team - Reporting	Meeting to review issues list across all sites, risk log and financial and contract monitoring	Weekly	Evidenced a weekly agenda
A&BC Project Team - Reporting	Highlight report to Customer Services and Community Services DMT and to SMT	Monthly	Evidenced highlight report as having been forwarded to SMT and forthcoming Customer Services DMT
A&BC Project Team - Reporting	Highlight report to P&R Committee	Bi-monthly	Report to be presented at the next P&R Committee meeting in August 2016.

- An initial highlight report dated 11th July 2016 has been prepared by the project team covering both Oban High School and Campbeltown Grammar School which will be presented at the next P&R Committee meeting (August). The highlight report covers the following areas:

- Legal updates
 - Financial updates
 - Technical updates
 - Risk Register
 - Work progress update
 - 2/4 week horizon in regard to forthcoming activities
- It was noted from the Key stage review that the P&R Committee has been delegated the authority to progress the project to financial close provided the project is not materially altered as regards changes to scope, costs or timescales. It was evidenced that a material change in terms of cost was defined as cost projections exceeded agreed budgets, however there was no reference as to what might constitute a material change to either the scope or timescale.

Review financial management arrangements including modelling, budgeting and general controls

- It was evidenced that a financial forecasting model has been prepared in consort with hub North covering the construction of the new Oban High School and Campbeltown Grammar School and includes the following:
 - Cash flows over the period till March 2043
 - Expected RPI scenario's
 - Financial impact of scenarios of delays to the project
 - Cost details by expenditure heading
- It was evidenced that the Financial Consultants BDO have reviewed the financial models on behalf of the Council and concluded that the model:
 - Is logically constructed, internally consistent, and is arithmetically accurate in material respects in terms of its formulae, algorithms, macros and calculations;

- Is consistent in material respects, with the inputs and assumptions contained in relevant extracts and schedules of the Project's principal contractual and financing documentation;
 - Calculates key financial and banking indicators with trends materially consistent with movements in underlying assumptions;
 - Reflects, in material respects, the provisions of the relevant accounting and financial reporting standards of UK GAAP;
 - Reflects, in material respects, current UK taxation legislation at the date of the report; and
 - Is sufficiently robust to run the sensitivities and produce output consistent with the changes made to assumptions.
- It was noted from the minutes of the Council meeting of 24th April 2014 that the following was agreed:
 - Capital contribution required for Oban High School of £11.27M and the additional capital requirement for Campbeltown Grammar School of £2.48M and an additional provision in the Capital Budget for 2017/18 of £13.5M.
 - Revenue contribution required for Oban High School of £1.05M and the additional revenue requirement for Campbeltown Grammar School of £0.27M and an additional provision in Revenue Budget for 2017/18 onwards of £1.32M per annum.
 - Financial regulation ESA10 states that new school projects are to be revenue funded. The consequence of this is that the Council will make a "Total Annual Service Payment" (ASP) which will cover all the costs of the DBFM including the Council's contribution and this will be paid over a 25 year period. The council has recognised the financial consequences of ESA 10 and the necessary financial processes are in place to accommodate this arrangement.
 - Project management cost centres have been created which cover the costs of both the full time project manager and project administrator. These cost centres are subject to periodic budget monitoring review in line with Strategic Finance reporting requirements.

Risks have been identified and mitigated against

- A risk register has been prepared for both Oban High School and Campbeltown Grammar School projects covering 9 identifiable risks.
- Active risk management is in place for each of the risks identified with mitigation actions in place and evidence of scoring assessments.
- Examples of risks detailed in the risk register are;

<u>Potential Risk</u>	<u>Risk</u>	<u>Mitigation Actions</u>
Inadequate Governance Reporting	Low	All matters related to Oban and Campbeltown Projects are delegated to the Policies and Resources Committee (P&R). Regular reporting to SRO, Departmental Management Team (DMT) and Strategic Management Team (SMT)
Insufficient monitoring of financial risk/budget	Medium	Regular budget monitoring carried out by SPT Finance Manager reported to SRO and DMT's and SMT, and reported in accordance with normal Council procedure.
Project may be delayed due to insufficient technical, financial or legal capacity	Medium	Experienced project team constituted by the Council with additional support from Facility Services and external advisers through the Scottish Futures Trust framework

- At the time of the audit the risk register is scheduled to be presented to SMT and then for further transmission to the P&R committee in August.

- It was noted that the Technical Advisors Report prepared after each site visit details the actions/issues that should be addressed and by whom, however there is no date as to when the action/issue should be completed by.
- It was evidenced from the Key stage review that a risk contingency of £302K has been allowed for the Oban High School which represents 1% of the prime costs and preliminaries and £214K for Campbeltown Grammar School which represents 1% of the prime costs and preliminaries.

6. CONCLUSION

This audit has provided a Substantial level of assurance. There is 1 medium recommendation and 1 low recommendation. Appendix 1 sets out the action management have agreed to undertake as a result of the medium recommendation, the persons responsible and the target date for completion of the action. Low recommendations are not reported to the Audit committee. Progress with implementation of actions will be monitored by Internal Audit and reported to management and the Audit Committee.

Thanks are due to the Project Team staff and management for their co-operation and assistance during the Audit and the preparation of the report and action plan.

APPENDIX 1 ACTION PLAN

Findings	Risk Impact	Rating	Agreed Action	Responsible person agreed implementation date
1. Material changes to project				High/ Medium or Low
There was no reference as to what might constitute a material change to either the scope or timescale.	Failure to define what constitutes a material change to scope or timescale may lead to material changes to the project that have not been agreed.	Medium	Protocol established with regards to the definitions of a material change to scope, costs or timeline.	Project Director Completed 31 st August

APPENDIX 2 ACTION PLAN

Findings	Risk Impact	Rating	Agreed Action	Responsible person agreed implementation date
1. Issues register		High/ Medium or Low		
It was noted that the Technical Advisors Report prepared after each site visits details the actions/issues that should be addressed and by whom, however there is no date as to when the action/issue should be completed by	Failure to have a completion date for issues may lead to issues not being addressed in a timely manner.	Low	The Technical Advisors report is prepared for the Project Team by Facility Services colleagues and includes monthly reporting on actions/issues. A timescale of rectification and review will be identified in the report to ensure that these are monitored and addressed.	Project Director Completed 31 st August



Contact Details

Name David Sullivan

Address Whitegates, Lochgilphead, Argyll, PA31 8RT

Telephone 01546 604125

Email David.Sullivan@argyll-bute.gov.uk

www.argyll-bute.gov.uk

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