



FINAL

Internal Audit Report

Community Services Department

Review of NPDO Schools

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1	DETAILED FINDINGS
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1. BACKGROUND

- 1.1 This report has been prepared as a result of the Internal Audit review of the NPDO Schools Project as part of the 2007/08 Internal Audit programme. We identified current practices and critically evaluated these having regard to the NPDO contract.
- 1.2 Argyll & Bute Council's NPDO model is the first of its kind in Scotland and has achieved a national award for innovation. It is a variant of PFI/PPP which captures the benefits of traditional projects, but has the potential to offer greater value for money to the Council. The NPDO is structured so that any surplus is made available to an educational charity nominated by the Council instead of being paid out to shareholders.
- 1.3 A Value for Money audit was carried out in March 2004 to ensure that the Council had appropriate systems in place to select and manage the NPDO project in an economic and effective manner. A further review was carried out by KPMG in July 2006 and this concluded that the procurement and implementation phases of the project were adequately controlled.
- 1.4 This audit review therefore focuses on the construction, completion and handover phases of the project.
- 1.5 Construction on Oban (phase1), Dunoon Grammar, Rothesay Joint Campus and Lochgilphead Joint Campus commenced in September 2005, with Hermitage Academy being brought into the NPDO project at a later stage.
- 1.6 Oban (phase 1) was handed over on 28 August 2006, and during the Summer of 2007, handover was achieved for Rothesay Joint Campus on 18 July 2007, Dunoon Grammar on 6 September 2007, and Oban (phase 2) on 5 September 2007. Lochgilphead Joint Campus was handed over on 22 October 2007. Construction work has continued on all sites to complete sports facilities and car parking, together with the demolition of old schools on the Dunoon and Rothesay sites. Hermitage Academy is due for completion and handover in February 2008.

2 AUDIT SCOPE AND OBJECTIVES

- 2.1 The broad objectives of the review were:
 - To review the performance measurement of the financial models, and reporting on the affordability of the project;
 - To review the contract monitoring arrangements for the construction, handover and operation of the new schools.
 - To review the calculation of the unitary charge on new schools ensuring that any relevant adjustments are identified and quantified.
 - To review and assess need for a more formalised Risk Analysis Framework and Business Continuity Plan

- 2.2 The adequacy of the arrangements to meet the objectives has been assessed using a grading of one to five ticks (✓ 's). Five ticks indicate good arrangements and one tick inadequate arrangements are in place. The assessment is set out in section 6 (figure 1). The assessment has been made by considering the value and significance of the findings and recommendations.

3 AUDIT APPROACH

- 3.1 The following approach was used to satisfy the objectives of the audit:

- An initial meeting was held with the Special Projects team.
- A copy of the main NPDO project contract was obtained, together with additional schedules covering the payment mechanism and service availability.
- Appropriate compliance and substantive tests were devised and carried out and as part of the exercise, visits were made to Rothesay Joint Campus and Dunoon Grammar School.
- A draft report was prepared and a copy passed to the Special Projects team for comments.
- Comments were included in the final report, which was then passed to the Director of Community Services.
- The final report includes an action plan, which lists all actions agreed with management.

4 SUMMARY OF MAIN FINDINGS

- 4.1 It is a significant achievement that the Council is currently in a strong position to avoid the disruption and expense of litigation and arbitration proceedings, and resultant cost over-runs, which have beset school PFI projects for other Councils.

The Council have endeavoured to achieve the maximum benefit of the fixed contractual price within the PFI contract by not requiring any significant design changes. Additional provision within the contract has been negotiated through the Reviewable Design Data (RDD) process, which does not result in any financial variation to the contract.

No direct claims have been notified to date from ABC Schools against the Council. However, construction cost over-runs have occurred, and on-going monitoring will therefore still be required to ensure that any potential claims arising, particularly in respect of construction delays, can be rejected as arising from factors outwith the contract or are directed at other members of the ABC Schools consortium.

- 4.2 Internal Audit found that the Affordability of the NPDO Schools project is being closely monitored with a spreadsheet model of actual revenue and expenditure being regularly updated to reflect the variances from the original projection at financial close, and reconciled to the Council budget.
- 4.3 The overall affordability of the project has benefited from the Late Service Availability of schools arising from construction delays. This has led to a consequent delay in incurring the Unitary Charge with the Revenue Support Grant profile remaining unchanged.

It has been recognised that the construction period is the riskiest element for all parties involved in the project. At present there is an apparent surplus within the Smoothing Fund of £4million, which is continuing to earn interest, but the impact of variations in the Retail Price Index, increases in utility charges and the finalisation of Non Domestic Rates are currently being assessed. Management have stated to Internal Audit that they are certain that any surplus will be reduced when the assessment process is complete.

- 4.4 ABC Schools Ltd. must not make distributions to its shareholders and any surpluses will be donated to a charity established to finance educational provision. It was not anticipated that any surpluses would arise during the early years of the project. However, the potential for profit may have increased due to the construction delays. This has resulted in a slower than anticipated draw down of the capital finance, thereby reducing the interest cost borne by the project. However, any resultant profit will still be dependent on future variables such as interest rates and inflation.
- 4.5 In common with most construction projects there are snagging issues arising at or after the Certification date of each building. Under the NPDO project these may give rise to financial penalties resulting in deductions from the unitary charge where performance or availability failures arise. The Council have withheld £45,000 against deductions arising on Oban Phase1 in the period since October 2006. It is anticipated that actual deductions will exceed this amount and the detailed calculations are close to finalisation. With the subsequent Certification of schools in the Summer & Autumn of 2007, all snagging issues are being transferred on to the Help Desk at the end of the initial 2 months acceptance period to provide an established mechanism for calculating on-going deductions.

5 ACTION PLAN

- 5.1 The action plan attached at Appendix 2 has been compiled with the co-

operation and agreement of the Special Projects team.

- 5.2 Internal Audit considers that, in an effort to improve the quality of information, monitoring and control, the recommendations should be implemented in accordance with the agreed action plan. Management have set achievable implementation dates and will be required to provide reasons to the Audit Committee for failure to implement within the agreed timescale. Where management decides not to implement recommendations it must evaluate and accept the risks associated with that decision.
- 5.3 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 fundamental, material or minor. The definitions of each classification is set out below:-

Fundamental - 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;

Material - 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 was rectified;

Minor - 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.

6 OVERALL CONCLUSION AND ASSESSMENT AGAINST OBJECTIVES

- 6.1 The Special Projects team have a strong understanding of the NPDO contract, its financial framework and required operating procedures. This is enabling them to exercise tight financial control over the costs of the project and ensure that the affordability of the project is kept under close scrutiny. However, during the course of the audit, some areas were identified as still in development or requiring some improvement and therefore, various recommendations have been made. These have been discussed with management and an action plan agreed. (Any issues not accepted by management are done so with their knowledge and acceptance of risk and control weakness.)
- 6.2 Figure one below sets out a summary of the overall conclusions arising from the audit in terms of the specific objectives detailed at section 2.1

Figure 1: Summary of overall conclusions

Specific objectives	Assessment
To review the performance measurement of the financial models, and reporting on the affordability of the project;	✓✓✓✓
To review the contract monitoring arrangements for the construction, handover and operation of the new schools.	✓✓✓✓
To review the calculation of the unitary charge on new schools ensuring that any relevant adjustments are identified and quantified.	✓✓✓✓
Review and assess need for a more formalised Risk Analysis Framework and Business Continuity Plan	✓✓✓

<p>Key:</p> <ul style="list-style-type: none"> ✓✓✓✓✓ - Arrangements accord with good practice and are operating satisfactorily. ✓✓✓✓ - Arrangements accord with good practice, but certain minor matters noted as requiring improvement. ✓✓✓ - Adequate arrangements in place, but certain matters noted as requiring improvement. ✓✓ - Arrangements in place offer scope for substantial improvement. ✓ - Concern is expressed about the adequacy of the scope of these arrangements.
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7 ACKNOWLEDGEMENTS

- 7.1 Thanks are due to the Special Projects team, and the schools visited, for their co-operation and assistance during the Audit and the preparation of the report and action plan.
- 7.2 Argyll & Bute Council's Internal Audit department has prepared this report. Our work was limited to the scope in paragraph 1.2 of this report. We cannot be held responsible or liable if information material to our task was withheld or concealed from us, or misrepresented to us.
- 7.3 This report is private and confidential for the Council's information only and is solely for use in the provision of an internal audit service to the Council. The report is not to be copied, quoted or referred to, in whole or in part, without prior written consent.

APPENDIX 2

ACTION PLAN

ACTION PLAN NO	PARAGRAPH	GRADE	POINTS ARISING	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
4	1.15	Material	The Affordability model requires to be updated to reflect deductions from the unitary charge when these are agreed.	When deductions are agreed the affordability model (and smoothing fund) will be updated appropriately.	QIO Special Projects	Ongoing
6	1.26	Material	The penalty deduction mechanism requires to be linked to the Help Desk and implemented in early course.	Mitie prepared their first contractual performance and payment report, including a Help Desk generated deduction figure, for the December 2007 invoice. The Authority will continue to monitor Mitie's performance to ensure these reports are provided each month in line with the contract.	QIO Special Projects	Ongoing from January 2008
8	1.33	Material	In view of the relative importance of the NPDO project and its high visibility	The formal quarterly reporting to the Director which was in place during	QIO Special Projects	From February 2008

ACTION PLAN NO	PARAGRAPH	GRADE	POINTS ARISING	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
			<p>within the community, we would recommend that the quarterly schedule of reporting is adhered to, and the opportunity is taken to provide a fuller overview of the construction progress and facility management issues arising at each location.</p> <p>In addition, recognising that there are only two key members of the Special Projects team it would be difficult for a new team member to familiarise themselves with the project without a full procedures manual being available. A timescale should therefore be set for completion of this manual.</p>	<p>the first 3 quarters of 2007 will be adhered to rigorously in 2008. The Team will continue to report informally on relevant issues as has been the case during the contract period to date.</p> <p>The draft procedures manual currently in place will be finalised in conjunction with the completion of the service plan and NPDO risk assessment described in item 10 below.</p>		<p>July 2008</p>
10	1.41	Material	<p>An exercise should be carried out to document the risks associated with the NPDO school estate, and ensure that they are reflected, or comply with the Corporate</p>	<p>Special Projects has commenced a risk analysis of all its work and resource requirements including the operation of the NPDO as part of its future service</p>	QIO Special Projects	June 2008

ACTION PLAN NO	PARAGRAPH	GRADE	POINTS ARISING	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
			<p>Risk Register approach. This will include assessing, from an operational risk standpoint, the changes in responsibility for disclosure checking of janitors and cleaners as well as ensuring that an overall disaster recovery plan is in place.</p>	<p>planning. This will be completed to provide a working tool to determine resource needs for future work.</p> <p>A detailed risk framework for the NPDO project itself will be undertaken. The approach used for the Corporate Risk Register will be applied, where appropriate, to ensure consistency of approach and format between the NPDO assessment and that of other departments.</p>		