

APPENDIX 1



Internal Audit Report

Operational Services

**Review of Tendering Procedures and
Capital Contracts – Argyll Air Services**

August 2008

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1. BACKGROUND

- 1.1 This report has been prepared as a contribution to the review of contract arrangements by Grant Thornton the Council's external auditors as part of their 2007/08 audit and the Internal Audit review of Tendering Procedures as part of the 2008/2009 Internal Audit programme. We identified the process for tendering work and awarding contracts including compliance with Council and EU procurement regulations; accountability and governance arrangements and contract monitoring and reviewed these processes as implemented on the selected project.
- 1.2 The project selected was Argyll Air Services to support the review of contract arrangements by the Council's external auditors who as part of their 2007/08 audit were reviewing a sample of significant projects and particularly requested assistance with the Oban Airport project and contract award and tendering. The Argyll Air Services project involved the processes and work involved in the development of the provision of air services between Oban and the islands of Colonsay, Coll and Tiree.
- 1.3 Within the overall project 8 different tenders were prepared, issued and evaluated and 2 consultants were appointed. These were as follows:-
- Tenders - Runway Works – Oban Airport
 Runway Works – Colonsay and Coll Airports
 Terminal Buildings – Oban Airport
 Terminal Buildings – Coll Airport
 Terminal Buildings – Colonsay Airport
 Provision of Air Services under a Public Service Obligation
 Provision of Rescue and Fire Fighting Vehicles.
 Provision of Control Tower Equipment – Oban Airport
- Consultancy - Assistance with Airport Licensing Process
 Support in preparation of a PSO contract.
- 1.4 As a result of our Audit work, findings were generated. These findings were subsequently discussed with management and a report produced.
- 1.5 During the course of our audit we became aware of an issue affecting the management of the project involving an existing on site tenant. As all paperwork regarding this had been removed from the contract files and passed to Legal Services our report has not considered the conduct of this matter.

2 AUDIT SCOPE AND OBJECTIVES

- 2.1 The broad objectives of the review were to ensure:
- Compliance with Council and EU procurement arrangements

- Accountability and governance arrangements
- Contract monitoring

2.2 The adequacy of the arrangements to meet the objective 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:

- Grant Thornton had completed the Project Planning stage of their review of contract management and highlighted any issues relating to the tendering of projects.
- Initially a meeting was held with the Project Supervisor
- We obtained the project files and reviewed the process from inclusion in the Council's capital plan to practical completion of a particular construction project or supplier service provision.
- It was explained that the Auditor would call for evidence on a sample basis as appropriate to back up the responses.
- The documents and information provided were reviewed by Audit and queries arising were subsequently raised with Auditees.
- Appropriate compliance and substantive tests were devised and carried out and as part of the exercise, visits were made to Roads Design, Manse Brae Office, Lochgilphead and Property Services, Argyll House, Dunoon
- All findings/matters arising were raised and discussed with the Project Supervisor.
- A draft report was prepared and a copy passed to the Head of Roads and Amenity Services and Grant Thornton for comments.
- Comments were included in the final report, which was then issued to Grant Thornton and the Director of Operational Services.
- The final report includes an action plan, which lists all actions agreed with management.

4 SUMMARY OF MAIN FINDINGS

- 4.1 Internal Audit found that the tendering process in respect of the Argyll Air Services project complied with Council and EU procurement arrangements
- 4.2 It is our opinion that this project has suffered from inadequate Council processes, procedures and organisational structures in relation to the initiation, approval, control and monitoring of capital projects. In summary this included:- a five year period, prior to the appointment of a project supervisor, in which no cost benefit appraisal was prepared; at least three transfers of overall responsibility for the project; appointment of a consultant ill equipped for the task on a project so complex that competent consultancy was an imperative; the project consisted of at least seven different complex operations/disciplines.

5 ACTION PLAN

The action plan attached at Appendix 2 has been compiled with the co-operation and agreement of the Project Supervisor and Head of Service, Roads and Amenity Services.

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.

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 were 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 Roads and Amenity Services has a good working knowledge of the processes involved. However, during the course of the audit, a number of areas were identified as requiring 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 objective detailed at section 2.1

Figure 1: Summary of overall conclusions

Specific objectives	Assessment
Compliance with Council and EU procurement regulations	✓✓✓✓✓
Accountability and governance arrangements	✓✓✓
Contract monitoring	✓✓✓
Key: ✓✓✓✓✓ - 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.	

7 ACKNOWLEDGEMENTS

- 7.1 Thanks are due to Roads and Amenity Services staff 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 section has prepared this report. Our work was limited to the scope in paragraph 2.1 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 1

1 DETAILED FINDINGS

Point 1 – Compliance with Council & EU procurement regulations

- 1.1 The process of publicising the project; selecting contractors to tender; issuing and receiving tenders and the appointment of contractors follows the appropriate regulations and standing orders.
- 1.2 Three tenders were not accepted within the period that tenders were open for acceptance as required by the tender documents, requiring the Council to request that contractors hold their tender prices or accept cost increases.
Refer to Action Plan No 1
- 1.3 Three suppliers returned tenders for the Oban Airport fire and rescue vehicles; the lowest was not considered because Strategic Finance was not satisfied as to their financial standing. The second lowest was discounted as the tender was non compliant. The accepted tender was £53k. more expensive than the lowest compliant tender. The accepted supplier failed to meet his contractual obligations and the contract was terminated in April 2007. Recovery of monies paid to the supplier in the sum of £161,280 under this contract is being pursued by Legal and Protective Services but remains unrecovered as of the date of this report.
With hindsight it may have been worth the risk to have accepted the lowest tenderer (discounted on basis of financial standing) No risk assessment of this possible action was carried out at the time. Irrespective of the accepted suppliers ultimate performance £53k. may have been saved under carefully managed circumstances. Perhaps where substantial savings can be achieved consideration should be given to suspending Standing Orders under controlled conditions.
Refer to Action Plan No 2

Point 2 – Arrangements for accountability, governance and approval

- 1.4 The success of the Argyll Air Services project was and remains very much dependant upon the licensing of the three airports at the required Civil Aviation Authority code level. This was recognised in 2001 when a consultant was appointed to assist the process. License applications for all three airports were submitted in 2005. However in January 2006 when 6 of the 8 tender processes were underway the minutes of a development meeting held at the CAA offices stated that “The fact that much of the development had been concluded prior to any formal involvement by the CAA meant that the Council were carrying a risk that the work may not be compliant with licensing requirements”. The CAA then issued three separate letters from three

sections within the CAA which indicated that they could not offer any opinion outside the licensing process.

- 1.5 Despite 4 studies in 2000 and prior and Oban Airport licensing requirements being investigated in 2001/2 no formal appraisal of the project was considered by the Council until October 2003. The lack of a formal appraisal process prior to £650,000 being allocated to the capital plan meant that costs were incurred in advance of the proper consideration of project need, benefit etc. The introduction in 2007 of the draft Capital Planning and Management Guide addresses this problem but requires full implementation.
- 1.6 The project while having political and strategic commitment appears to have been predicated on the basis that funding for the project might be available rather than a need and as a result the process has been driven by availability of funds and the need to firm up costs rather than the appropriate specification to meet service need and statutory air service obligations and provide funding justification. Again the introduction in 2007 of the draft Capital Planning and Management Guide addresses this problem but requires full implementation.
- 1.7 The tender specification for the runway at Oban airport assumed that a CAA code 2 airport license would be applied for and obtained. See 1.4 above where the CAA regarded this as a risky strategy. However if the Council had not persevered the likelihood of an island air service would be an ever more remote possibility. Until licensed airport status was obtained the strategy would have been regarded as at risk but with appropriate personnel in place sooner and/or better co-ordination of in-house services the Council may have found itself being congratulated for its foresight.

Refer to Action Plan No 3 & 9

- 1.8 The tender opening record for Oban airport terminal building compares an estimated value of £820K with a lowest tender sum of £1.068m. while the tender assessment record refers to cost plan of £704k. and accounts for the increases but does not provide an explanation between cost plan and tender estimated value. It is important that Property Services and/or Roads Design are consistent in their use of figures in order that like for like comparisons are made and explanations of differences can be relied upon.

Refer to Action Plan No 4

Point 3 – Contract Management

- 1.9 The contract period for the Oban airport terminal building extended well beyond that envisaged at the tender stage and beyond the period after an extension of time was granted. This was due to additional work required to accommodate changes to the Control Tower.
- 1.10 The contract period for the Colonsay and Coll airport terminal buildings extended well beyond that envisaged at the tender stage and beyond the period after an extension of time was granted. While extensions of time were

granted on both contracts these did not cover all of the delay and Liquidate and ascertained Damages were deducted from the contractors valuation payments.

- 1.11 The specification for 2 rescue and fire fighting vehicles at Oban airport prepared by external consultants required “Landrover” type chassis and ABS braking. However the fact that Landrover do not fit ABS braking on their chassis resulted in the recommendation of the vehicle body being constructed on a relatively untried chassis. There appears to have been no attempt by the external consultants to verify that Angloco had worked previously with a Breamach Chassis.

Refer to Action Plan No 5

- 1.12 From the date of acceptance of the tender to provide fire and rescue vehicles to the pre build meeting and beyond to the construction review meetings it was clear that issues were arising. Despite this no adverse report was received from the external consultants.

- 1.13 With hindsight it is clear that our legal and engineering responses to the vehicle build delays and technical shortcomings should have been much better co-ordinated. It is important that a manager involved in the ultimate operation needs to be assigned the responsibility for the specific contract management while the co-ordination of the legal and engineering processes, to ensure that conflicting messages are not perceived by the supplier/on-site contractors/tenants regarding the Council’s course of action, remains the project manager’s responsibility.

Refer to Action Plan No 6

- 1.14 The contractor for the Oban runway works has submitted a claim for delay and unforeseen ground conditions. This he is entitled, indeed, required to do under the contract and the Council will be liable for at least an element of delay. However the claim concerning ground conditions will be resisted. Delays occurred as it was impossible for the Terminal Buildings work and the civil engineering work to proceed simultaneously for part of the time and work instructions re rescue and fire fighting vehicles were being given late in the contract period. The final measure has now been agreed and significant progress has been achieved with regard to the claim.

Refer to Action Plan No 7

- 1.15 A very large quantity of aggregate material was required to be transported across Coll to the airfield site and in the process extensive damage was incurred on the island road. While the contract sum included an allowance (approx. 7.5%) for temporary road repairs the actual cost was hugely in excess of this with temporary repairs costing some £190k. and permanent reinstatement some £650k. It was considered that the allowance in the contract would cover temporary and permanent repairs to the equivalent of 1.5 kilometres when in fact some 8.5 kilometres were permanently reinstated.

- 1.16 The vehicles were due for delivery from Angloco in Mid January 2007. Following a pre build meeting in July 2006 attended by the external consultants and an unsatisfactory pre delivery inspection by the Council's Senior Airport Fire Officer in November 2006, the inspection trip to verify achievement of specification took place in March 2007 and was carried out by the Council's Senior Airport Fire Officer, during which major performance non-conformities were identified.

Refer to Action Plan No 8

APPENDIX 2

ACTION PLAN

ACTION PLAN NO	PARAGRAPH	GRADE	WEAKNESSES IDENTIFIED	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
1	1.2	Fundamental	During the course of this project the Council consistently had to request tenderers to hold prices beyond the date the tender was open for acceptance.	Tenders for any supply or work to be carried out should not be invited unless a formal acceptance can be issued within the period the tender remains open for acceptance.	Head of Service, Roads & Amenity Services	The implementation of the Capital Programme Planning and Management Guide will assist this action. September 2008
2	1.3	Fundamental	(a) As the two lowest tenderers for the fire and rescue vehicles at Oban airport were in effect non compliant the Council was obliged to pay £53k. more than might otherwise have been the case. (b) A tender was invited from a supplier, whose tender was discounted, as his financial standing was not considered adequate when investigated by	Instruction should be issued to relevant managers that where the price gap between a lower but non compliant tender and the lowest compliant tender exceeds 20% the non compliant tender should be reviewed and the risks of acceptance by the suspension of Standing Orders assessed and reported to the Executive Committee.	Head of Service, Roads & Amenity Services	September 2008

ACTION PLAN NO	PARAGRAPH	GRADE	WEAKNESSES IDENTIFIED	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
			Strategic Finance			
3	1.4 to 1.7	Fundamental	This project commenced with the appointment of a working group on 7 th January 1998. The Licences for Oban, Coll and Colonsay airports were finally granted by the CAA on 5 th June 2008.	Major infrastructure projects, particularly involving a variety of non standard operations/services, must be formally considered and approved, with care taken to set aims and priorities such that adequate resources can be applied to the project and a programme of implementation/progress/ completion devised and agreed with all parties This could be achieved with adoption of the proposals within the Draft Capital Planning and Management Guide which is shortly to be finalised.	Head of Service, Roads & Amenity Services	The implementation of the Capital Programme Planning and Management Guide will assist this action. October 2008
4	1.8	Minor	The Oban airport terminal building Tender Opening Record compares an estimated value of £820K with a lowest tender sum	It is important that Property Services and/or Roads Design are consistent in their use and description of figures in order that like for	Head of Service, Roads & Amenity Services And	October 2008

ACTION PLAN NO	PARAGRAPH	GRADE	WEAKNESSES IDENTIFIED	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
			of £1067.825K.while the tender assessment record refers to cost plan of £704k. and accounts for the increases but does not provide an explanation between cost plan and tender estimated value.	like comparisons are made and explanations of differences can be relied upon rather than confusing to the reader. To this end standard terminology should be used and a glossary of terms prepared for use by Members and Officers.	Head of Facility Services	
5	1.11	Material	The consultants used to specify, and recommend possible suppliers of, fire and rescue vehicles do not appear to have been up to the task.	Project Board Terms of reference should be prepared and include:- Where specialist equipment or services are to be acquired as part of a project the Project Manager, reporting to a project board, should be given full responsibility for ensuring that the Council obtain the most technically competent and experienced consultancy expertise and/or staff to deliver the project.	Head of Service, Roads & Amenity Services	November 2008
6	1.12	Fundamental	Where a construction	Prepare Project Manager's	Head of	November 2008

ACTION PLAN NO	PARAGRAPH	GRADE	WEAKNESSES IDENTIFIED	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
			<p>project encounters delays or specification difficulties and other Council Services become involved in the process of resolution there appears to be a basis for abdication of responsibility.</p>	<p>Terms of reference should make it clear that the Project Manager of a project is responsible for the progress and completion of the construction of the project regardless of the input required from internal or external resources not necessarily under his direct control. To assist in this process a Project Board consisting of senior members and officials should be appointed at the start of a project. It is important that the selection of the project board members reflects the nature and complexity of the project!</p>	<p>Service, Roads & Amenity Services</p>	
7	1.13	Minor	<p>Two separately specified and tendered construction projects were carried out concurrently at the Oban airport site. Although</p>	<p>An instruction should be issued that this practice should be avoided if at all possible but when necessary must be</p>	<p>Head of Service, Roads & Amenity Services</p>	<p>October 2008</p>

ACTION PLAN NO	PARAGRAPH	GRADE	WEAKNESSES IDENTIFIED	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
			recognised at tender stage the contracts were adversely affected.	specified at tender stage and contractors advised to take account of the nature of both works in devising their contract programmes which should be formally approved by the Project Manager.		
8	1.16	Fundamental	Despite pre-build and pre-delivery inspections, of the fire and rescue vehicles ordered from Angloco, taking place, an inspection to confirm achievement of specification found serious non-conformances some time after the original delivery date had passed	Prepare Project Managers Terms of Reference to include:- All contracts involving a construction process must include a build programme and review process as part of the contract documentation and conditions. This should be extended to all contracts where appropriate and it should be the responsibility of the Project Manager to ensure compliance of the parties to the contract regardless of the involvement of consultants.	Head of Service, Roads & Amenity Services	November 2008

ACTION PLAN NO	PARAGRAPH	GRADE	WEAKNESSES IDENTIFIED	AGREED ACTION	RESPONSIBLE OFFICER	DATE OF IMPLEMENTATION
9	1.4 to 1.7	Fundamental	Projects involving a variety of skills in a concurrent time frame viz. Civil Engineering Building and construction Fire and rescue Airport operation Flight service provision Special licensing provisions also require unique project management skills not necessarily readily available in-house.	One or two senior project managers should be identified and selected for training on complex project management and the use of current techniques.	Head of Service, Roads & Amenity Services	This is in progress as part of our normal development and training process but will be further reviewed. October 2008