

APPENDIX 2

Argyll and Bute Council 2007-08
Contract Management



Grant Thornton

Argyll and Bute Council

Contract Management

March 2009

APPENDIX 2

Argyll and Bute Council 2007-08
Contract Management

Contents		Page
1	Executive Summary	1
2	Detailed findings	3

Appendices

- A** Action plan
- B** Significant Capital Projects over £1million

1 Executive Summary

1.1 Introduction

The Council spends significant sums annually on its capital programme and needs effective contract management arrangements in place to ensure capital projects are prioritised in accordance with corporate priorities, contracts are awarded in line with legislative requirements, and good budget and project management arrangements are in place to deliver value for money.

A lack of effective contract management arrangements may lead to both financial and reputation risks for the Council, and poor value for money. As part of our 2007-08 audit, we have reviewed the Council's arrangements for contract management. Our findings will help inform the Council of any areas where action is required to strengthen arrangements.

As part of our audit, we reviewed the contract management arrangements for the Argyll Air Services contract. This contract included the construction of airports at Oban, Coll and Colonsay. The first scheduled flight between these airports took place in June 2008. Oban Airport was formally opened in August 2008, by the Minister for Transport, Infrastructure and Climate Change.

1.2 Scope

Our review covered the main aspects of contract management, including:

- the planning process for projects, including feasibility studies, business plans and initial budgeting and forecasting
- the procurement process
- the management and monitoring of projects during the construction phase
- the operational plans for projects, including financing and post project completion.

We carried out our work in tandem with internal audit, who have reviewed the contract and tendering arrangements for a number of key capital projects during the year

1.3 Key findings

We found a number of weaknesses in the Council's contract management arrangements, particularly in relation to the management of the Argyll Air Services Project. Our key findings are outlined below:

Contract design

- the preliminary studies for the project were commissioned several years before the project began, and were not fully updated for changes to the project
- the preliminary studies, and work of external consultants, did not fully cover all aspects of the Argyll Air Services project, resulting in unanticipated costs.

Contract management

- the Council appointed aviation consultants to undertake preliminary studies in preparation for the contract, but the project management team did not have specific experience air transport construction projects
- weaknesses in contract management arrangements, and external consultant performance, led to increases in the overall costs of the project
- the effect of the importation of construction materials on the Coll road network, although allowed for, was not sufficient to cover the damage caused and led to additional costs being incurred
- an operational or business plan for Argyll Air Services has not yet been developed.

We note that the Council has revised its project management arrangements since the commencement of the Argyll Air Services contract. All recent capital contracts have been managed under these new arrangements which meet good practice guidelines.

1.4 Looking forward

Our report makes 8 recommendations, of which 3 are categorised as high priority. In summary, the Council should review its capital planning and contract management procedures to become more effective in the following key areas:

- prioritising capital projects in line with corporate priorities
- ensuring key project decisions are fully documented at all stages of the contracting process
- developing arrangements for managing risk at all stages of the procurement and delivery stages of capital projects.

In addition, we have recommended that the Council consider setting up a separate management account for Argyll Air Services to ensure greater transparency in the decision making and monitoring arrangements for the Council's airports.

The findings and recommendations from our review are summarised in an action plan at Appendix A. The action plan has been agreed with management and incorporates the management response to audit recommendations. We will follow up the Council's progress in implementing the agreed action plan as part of our 2008-09 audit.

1.5 About this report

This report is part of a continuing dialogue between the Council and Grant Thornton UK LLP and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in the Council's systems and work practices.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on it. This report includes some specific recommendations to strengthen internal controls. It is the responsibility of management to decide the extent of the internal control system appropriate to the Council.

1.6 Acknowledgements

We would like to take this opportunity to thank Council staff who have been involved in this review for their assistance and co-operation.

2 Detailed findings

2.1 Introduction

Contract management can be defined as the process that enables both parties to a contract to meet their obligations in order to deliver the objectives required from the contract. It also involves building a good working relationship between the parties that continues throughout the life of a contract and involves managing proactively to anticipate future needs as well as reacting to situations that arise.

The main objectives of contract management can be summarised as:

- obtaining the goods or services as agreed in the contract
- achieving the corporate and strategic objectives associated with the contract
- achieving value for money.

This requires optimising the economy, efficiency and effectiveness of the project the contract relates to, balancing costs against risks and actively managing the relationship between the parties. Contract management may also involve aiming for continuous improvement in performance over the life of the contract.

For public sector bodies, the most significant contracts are those related to the capital programme. The size and significance of the capital programme requires the Council to have effective arrangements in place to ensure capital projects are prioritised in accordance with corporate priorities, contracts are awarded in line with legislative requirements, and good budget and project management arrangements are in place to deliver value for money.

As part of our 2007-08 audit, we conducted an overview of the Council's contract management arrangements and a detailed review of the operation of those arrangements for the Argyll Air Services contract.

2.2 Background

Overall Capital Programme

The Council spends significant sums annually on its capital programme, with net expenditure of £15.6 million in the 2007-08 financial year. The total value of the Council's current capital programme is £153.7 million and a summary of planned capital projects with a projected cost in excess of £1 million is included in Appendix B.

The total capital programme involves the management of numerous contracts, each with their own unique requirements. Effective contract management arrangements are, therefore, an important aspect in achieving the Council's corporate objectives.

Argyll Air Services Contract

The Council own and operate 4 airports in Argyll and Bute sited on Coll, Colonsay, Glenforsa (Mull) and Oban. In addition, Highlands and Islands Airports Limited operate 3 airports in Campbeltown, Islay and Tiree.

In 2003, the Scottish Government signed an agreement with the Council to fund the expansion of the airport in Oban, with additional funding for Coll and Colonsay airports provided through GAE. This allowed scheduled passenger flights to operate between Oban and the two islands and the existing airport at Tiree. Previously, the islands of Coll and Colonsay could only be reliably reached by ferry and the provision of scheduled air services was seen as a strategic priority for improving local transport links and allowing an increase in the provision of public services to the islands of Coll and Colonsay.

The Argyll Air Services project is a large and complex capital projects, involving the following 10 contracts:

- a new runway and terminal building at Oban, Coll and Colonsay Airports (5 contracts)
- control tower equipment
- fire fighting and rescue vehicles
- provision of air services under a Public Service Obligation (PSO) format
- consultancy services to assist with the PSO tender
- consultancy services to assist with the licensing requirements for the 3 airports.

Funding for the project was provided by 4 partners, detailed in Table 2.

Table 2: Argyll Air Service project funding

Partner	Funding (£million)
Argyll and Islands Enterprise (AIE)	£1.492
Highland and Islands Transport (HITRANS)	£1.200
European Regional Development Fund (ERDF)	£1.986
Oban, Lorn and the Isles Area Committee Funds	£0.050
Total partner contributions	£4,728
Council contribution	£3,772
Projected Outturn	£8,500

Source: Argyll and Bute Council

The Scottish Government provides cover for the loan support charges resulting from the Council's capital contribution to the scheme, and will provide revenue support for the operation of Oban Airport and the operation of the public service obligation routes when the project is complete. The Council remains responsible for the cost of the operation of Coll and Colonsay Airports (Tiree Airport continues to be operated by Highlands and Islands Airports Ltd).

This arrangement ensures that the majority of costs associated with constructing and operating Oban Airport do not fall on the Council. The Council also receives additional funding for constructing Coll and Colonsay airports, but contributes £170,000 towards the overall costs of these airports.

2.3 Project planning

The scale and variety of the Council's capital programme means that the approach to contract management varies between projects. However, there are fundamental aspects of contract management that should be undertaken at the planning stage to ensure projects are properly approved before the Council is committed to fund expenditure.

In February 2007 the Council agreed an approach to weighting and scoring capital projects, requiring consideration of:

- the impact on corporate plans and strategic objectives
- affordability with respect to the capital and revenue budgets
- whether the project can be delivered successfully
- risk management.

Since this approach was introduced, the Council has completed a Corporate Plan and Statement of Intent and has introduced a 'Gateway Review' process for new capital projects. All new and recently commissioned capital projects will, therefore, be subject to the new review process.

Action plan point 1

Planning for the Argyll Air Services contract started with a number of preliminary studies commissioned by the Council and its partners between 1998 and 2003. The studies looked at the practicality of achieving licensed status and the construction works likely to be required in conjunction with this, and analysed the potential demand for air services between Oban and the islands.

The preliminary studies made assessments of Oban Airport, and Coll and Colonsay Airports covering topographical survey work, aviation assessments and drainage studies. These preliminary studies were commissioned by the Council several years before the contract and tendering phases of the contract began and there was no evidence that they had been updated to ensure key assumptions continued to apply prior to signing the contract.

Action plan point 2

The construction of an airport requires elements of specialism outwith the normal workings of the Council and, therefore, carries additional risk. Whilst the Council received advice from a range of specialist aviation consultants, a detailed assessment of the risks associated with the Project was not prepared prior to commencement of the works.

Action plan point 3

There was a significant overspend on Coll Airport, as the construction materials transported to the island to build the runway caused significant damage to the existing road network between the harbour and the airport, with the result that the road network had to be repaired. This led to an overspend of approximately £770,000 in the airport construction budget for Coll, but also resulted in 8.5km of high standard road on the island which will bring additional future benefit.

The preliminary assessment of the Coll airport site identified that approximately 1km of the network was likely to require repair work on conclusion of the site works and an allowance of 10% of tender cost included for this purpose - significantly below the eventual cost outturn. As the likelihood of these additional works were known in advance, the original budget should have incorporated a more realistic estimate for the costs.

Action plan point 4

2.4 Tendering

The Council's procurement procedures detail the steps to be followed when undertaking major procurement exercises. The procedures ensure the Council complies with European Union (EU) legislation on public procurement which are designed to ensure fairness and equity in the expenditure of public funds, and to prevent illegal state aid.

Internal audit carried out a review of the contract and tendering arrangements for Argyll Air Services, including compliance with Council and EU procurement guidelines.

Internal audit have reported their findings to management in their report, *Review of tendering procedures- Argyll Air Services*. The report concluded that the project complied with Council and EU procurement guidelines. However, internal audit noted the following points with regards to contract and tendering arrangements:

- during the course of this project the Council had to request tenderers to hold prices beyond the date the tender was open for acceptance
- there were discrepancies between the Oban airport terminal building Tender Opening Record and the tender assessment record but no explanation for the discrepancy between cost plan and tender estimated value was documented.

Management have accepted these findings and have agreed to take action to improve tendering arrangements.

2.5 Contract Management

In order to ensure effective management of contracts, a plan should be in place to monitor progress of the contract against the stated outcomes.

Each project is assigned a project manager. The role of the project manager is to manage the day-to-day running of the project. This includes preparation of tenders, monitoring contract delivery and reporting on the capital budget. The project manager is assigned from the service managing the contract.

The Argyll Air Services project was managed by different staff during the early stages due to changing responsibilities within the Council and moved between services due to structural

reorganisation. Project management originally rested with Development Services but was eventually managed by Roads and Amenity Services.

The project managers assigned by the Council were experienced civil engineers, but had no prior experience of the air transport industry. Subsequent appointments to the project included an Airport Development Manager and Senior Fire Officer, both of whom had significant prior experience in managing the operational and fire services at other UK airports. These appointments took place after the contract and tendering procedures had been completed and the construction phase had begun.

2.6 Monitoring arrangements

A pre-licensing inspection by the Civil Aviation Authority (CAA) identified a number of areas of non-compliance with the licensing requirements. The rectification of these matters by the Council led to a significant delay in obtaining the necessary licences to operate the 3 airports with a subsequent increase in the cost of the Project and a loss of income during the period when the airports could not be used.

One element of additional cost related to the outcome of the Council's contract for airport fire engines. During the build process, Council officers identified that the vehicles did not fully meet the contract specification and would be of no use in satisfying the CAA). The vehicles were therefore rejected as being non-compliant, and the Council had no choice but to acquire replacement vehicles at short notice to meet CAA licensing requirements. These replacement vehicles did not fit into the garaging facilities built to house the original fire engines resulting in a requirement for additional works.

Having reviewed the correspondence associated with this issue, it is our view that the Council took appropriate action on a timely basis to ensure CAA licensing requirements were met in relation to the availability of airport fire engines. We understand that the Council is seeking compensation from the contractor to recover payments made and any consequential costs incurred in relation to this matter.

Whilst some of the areas of non-compliance were outwith the Council's control, a number of issues added to the final cost of the project which the Council should have addressed in advance. These included:

- the cost of reconstructing roads on Coll which were damaged by the heavy construction materials transported to the island to build the new runway and terminal building (this was identified and addressed but insufficiently so)
- the identification by the Airport Development Manager of some CAA licensing requirements which had not been notified to the Council by its aviation consultants. This led to additional costs being incurred principally in the areas of emergency water supplies (£40k), radio and communication needs (£110k) and rescue aids in the event of an aircraft crashing into Loch Etive near Oban airport (£70k)
- the design specification for the control tower at Oban Airport did not allow for the safe installation of air traffic control equipment and an adjustment to the floor level was required as a result
- the control tower did not allow an unrestricted view of the runway in line with CAA requirements - this was overcome by the fitting of CCTV cameras.

Action plan point 5

2.7 Budget monitoring

Capital plan monitoring reports

A capital plan monitoring report is produced on a monthly basis by the Head of Strategic Finance. The report is reviewed by the Senior Management Team and is subject to quarterly review by the Executive.

The report analyses all the capital projects underway by service, and uses a "traffic lights" system to monitor:

- expenditure during the year
- project total cost
- project timescale
- project benefits
- project risk.

Service heads are required to produce a report for each project with a red classification. The report summarises the issue causing the performance rating, the proposed action to rectify the problems, and the implications of the action. In the case of the Oban airport contract, the cost increases and reasons for them were regularly identified and reported to senior management and members.

Argyll Air Services

Table 3 below shows performance against budget for the Argyll Air Services project as at March 2008 and June 2008 from the capital plan monitoring reports.

Table 3: Argyll Air Services performance against budget

Stage	Estimated expenditure £m	Variance from original tenders £m
Original tenders	5.5	-
March 2008	8.5	3.0
June 2008	9.0	3.5

Source: Argyll and Bute Council capital plan monitoring reports (March 2008 and June 2008)

The additional costs relate mainly to unforeseen spend for air traffic control equipment, fire engines, and safety works identified by the CAA. In addition, there was a budget overspend of £1 million in the construction of the runways at Oban and Coll Airports. A further £0.5 million was added to the budget between March and June to cover staff and consultancy costs associated with the delay in achieving CAA certification, and potential claims for excess costs by contractors.

Revenue budget figures have been prepared as part of the Council's service budgets for the 3 year period from 2008-09. Argyll Air Services is included with Roads and Amenities Services and there are separate cost centres that allow the costs and income for Argyll Air Services to be extracted and reported on. Reports have been submitted to the Council on several occasions showing 3 years financial projections for Argyll Air Services, however, there is no separate business analysis.

The Council has made no detailed assessment of whether the early projections for passenger numbers continue to be sustainable and the extent to which the airports will be required to rely on Scottish Government subsidy.

Oban Airport is funded to carry 592 passengers per month under the Public Services Obligation arrangement. Each flight has a capacity of 8 passengers, with approximately 74 flight movements expected each month. A total of 342 passengers used Oban Airport during September and October 2008, which is below the Council's projection of passenger numbers of 380 for that period. It is too early to determine if passenger demand for the service will meet expectations.

Action plan point 6

As Argyll Air Services operates separately from the Council's main activities and partly on a commercial basis, the Council should consider preparing detailed management accounts on a regular basis to improve budget setting and monitoring arrangements.

Action plan point 7

2.8 Post project completion

Post completion reviews

The Council's approach to capital planning was agreed by the Executive in December 2006. This requires a post completion review of major capital projects in line with good practice guidelines. The objectives of such a review are to:

- assess the performance of the Council and the contractor during the project
- consider whether the project has achieved its objectives
- evaluate the impact of the project
- identify good practice and areas for improvement emerging from the project and ensure good practice is applied to other projects going forward.

Post completion review are undertaken as part of a 2 stage process, firstly once the construction phase is complete and then after several years post completion to ensure the project is delivering the ongoing benefits outlined in the business case. The second stage review of the Argyll Air Services contract will, therefore, take place in due course.

Management of Argyll Air Services

Both the Airport Development Manager and Senior Fire Fighting Officer who were appointed during the construction phase have now left the Council. A permanent airport manager has been appointed. Going forward, airport staff will report to a Marine and Airports Manager who in turn will report to the Head of Roads and Amenity Services.

Airport administration is a specific specialism, outwith the normal activities of a local authority. As such the Council should consider the future development of the airports, in particular the following options:

- subcontracting the management of the airport to a third party
- selling the airport to a third party
- to retain the airport within existing structure of the Council.

If the Council decides to retain the airports, a business plan should be in place which details the financial and operational plans for the airports over the medium term.

Action plan point 8

A Action plan

No.	Observation	Recommendation	Priority	Management Response	Responsible officer and implementation date
Business planning and contract tendering					
1	The Council does not always adequately document the decision making process at key stages of the contract management process. For example, proposed capital projects should be subject to a documented review to ensure objectives match the strategic objectives set out in the Corporate Plan and Statement of Intent.	In implementing the Gateway Review process for contract management, future capital projects should incorporate a review prior to approval to demonstrate that project objectives match strategic objectives.	Medium	This point has already been actioned. All Strategic change capital projects require to complete initial, outline and final business cases that must pass through a gateway process before final approval is given	Already actioned
2	There was no evidence that preliminary studies completed for the Project in 1998 had been updated to ensure key assumptions continued to apply.	The Council should ensure business planning documents are kept up to date and remain relevant throughout the project life.	High	Final business cases which will be the final decision point for determining whether to proceed with a strategic change capital project will be based on tendered capital costs and updated revenue costs.	Already actioned.
3	A detailed assessment of the risks associated with the Project was not undertaken prior to commencement of the works.	All major capital projects should be subject to detailed risk management procedures, including a risk assessment prior to commencement of the works.	High	Initial, outline and final business cases will require risks to be identified and reviewed as a project develops. Use of Prince 2 approach will require projects to maintain a risk log.	Already actioned.

No.	Observation	Recommendation	Priority	Management Response	Responsible officer and implementation date
4	There was limited evidence supporting a review of the condition of the road network on the island of Coll, and there was a significant overspend against the original budget.	The Council should ensure there is adequate evidence to support estimates incorporated in capital projects.	<i>High</i>	With final business cases being based on tendered costs and with review of risks there should be sufficient evidence and challenge to back up capital cost estimates. However a contingency by its nature is always going to be an estimate.	Already actioned
Business planning and contract tendering					
5	A number of issues added to the final cost of the project which the Council should have identified and addressed in advance.	The Council should ensure contract preparation arrangements adequately identify all material costs likely to be incurred for major contracts.	Medium	The final business case for strategic change projects will also act as a double check on adequacy of capital cost estimates and cross check these to project scope.	Already actioned

6	It is too early to determine if passenger demand for Argyll Air Services will meet expectations and justify the significant investment in the scheme.	The Council should plan to review existing projections for passenger numbers at its airports to ensure the original business model continues to be sustainable.	Medium	<p>It is agreed that the project should be reviewed and it is felt a complete year's operation would allow such a review to establish performance against the initial PSO model.</p> <p>This is against the position of the investment having been made to promote social cohesion and support for remote island communities on Coll, Colonsay and Tiree.</p>	Marine and Airfields Manager with Head of Roads and Amenity Services
7	Argyll Air Services operates separately from the Council's main activities and partly on a commercial basis ..	The Council should consider preparing separate management accounts for Argyll Air Services to improve budget setting and monitoring arrangements.	Medium	Financial and service performance targets will be set for the Air Service project as part of the Planning & Performance Management Framework. This will include targets set in the service plan and included in the performance scorecard. We see no case to establish separate planning & performance management arrangements out with PPMF for a single aspect of a service. Within the service it will monitor performance and budget.	

No.	Observation	Recommendation	Priority	Management Response	Responsible officer and implementation date
8	If the Council decides to retain the airports, a business plan should be in place which details the financial and operational plans for the airports over the medium term.	<p>A business and operational plan should be prepared for Argyll Air Services.</p> <p>This will detail the Council's plans for managing the airports going forward.</p>	Medium	Current view of the Council is that the airports should remain in Council ownership, albeit the need for ongoing review of the business and operational plan for Argyll Air Services and the airports will be part of the Departmental Service Planning process.	<p>Marine and Airfields Manager with Head of Roads and Amenity Services.</p> <p>Budget process for 2010/11</p>

B Significant Capital Projects over £1million

Table 1: Significant capital projects over £1m

Project	Budget £million	Details
Campbeltown Grammar School	£3.151	Refurbishment of the school estate
Port Askaig Pier	£12.910	Redevelopment of Port Askaig Pier
Oban Development Road	£13.154	Construction of a new road in North East Oban
Cuan Ferry Slipways	£3.300	Reconstruction of ferry slipways
A848 double track road construction	£13.220	Construction of double track road between Gualan Dhubh and Salen
Argyll Air Services	£9.010	Upgrade of Oban, Coll and Conolsay airports for scheduled flights
Rothesay Harbour	£14.083	Redevelopment of Rothesay Harbour
Dunoon Pier	£4.800	Redevelopment of Dunoon Pier
Bridge Strengthening Project	£4.683	Council wide project for bridge strengthening and replacement
Kilbride Road	£1.200	Flood prevention scheme
Milton Burn Road	£2.913	Flood prevention scheme
Flood Prevention General	£1.439	Council wide drainage improvement schemes
Helensburgh Operational Services Depot	£1.364	New Operational Services Depot
Mull and Islay Landfill Sites	£4.060	Redevelopment of landfill sites on Mull and Islay
Roads Reconstruction	£15.070	Reconstruction of priority roads in the Council area
Oban High Community Facility	£1.053	Football pitch construction

Source: Capital Monitoring Report March 2008



Grant Thornton

www.grant-thornton.co.uk

© 2009 Grant Thornton UK LLP. All rights reserved.

"Grant Thornton" means Grant Thornton UK LLP, a limited liability partnership.

Grant Thornton UK LLP is a member firm within Grant Thornton International Ltd ('Grant Thornton International'). Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered by the member firms independently.

This publication has been prepared only as a guide. No responsibility can be accepted by us for loss occasioned to any person acting or refraining from acting as a result of any material in this publication