



INTERNAL AUDIT, RISK & COMPLIANCE SERVICES

Argyll & Bute Council
Internal audit report – Capital contracts
19 June 2009

Report Number 003

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ADVISORY

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Distribution

For action

Arthur McCulloch Principal Engineer. Roads and Amenity Services

For information

The chair and members Audit Committee
 Bruce West Head of Strategic Finance
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Executive summary

Summary of objective and scope

As part of the 2008-09 internal audit plan, as approved by the audit committee of Argyll and Bute Council (“the Council”), an internal audit review of the capital contracts was performed in February and March 2009.

The overall objective of this review was to consider the processes and controls to manage capital contract tendering within roads and amenity services, which forms part of the operational services directorate. The project focused upon the capital projects classified ‘service development’ and ‘asset sustainability’, excluding capital projects classified ‘strategic change’ due to this area being subject to recent review. This internal audit excluded consideration of the post approval and contract compliance phases of contract management.

The specific objective, scope and approach in respect of this internal audit are detailed in Appendix 1.

Background

The Council operates a significant annual capital programme across a diverse range of projects. The main capital expenditure is within the operational services directorate, more specifically within roads and amenity services. The projects range from roads, bridge maintenance to airport development and harbour construction. The 2009-10 capital budget for the operational services directorate is £18.6 million against an overall capital budget for the Council of £35.1 million.

Individual capital projects pass through a capital justification and business case process prior to approval. Once approved the project is progressed by the design group or contracting group, within roads and amenity services, who identify the potential suppliers and manage the subsequent tendering process.

The contracting group are solely responsible for sourcing and tendering for additional resource or specialist skills not already available within the Council, while the design group are accountable for most tenders linked to the following activities:

- construction or replacement of bridges;
- building or upgrades to new or existing roads; and
- construction or development of harbours, piers and airports.

Detailed work instructions exist that outline the steps that the tendering processes should follow. Additional, high level, guidelines are also included within the Council’s standing orders.

Key findings and recommendations

The findings identified during the course of this internal audit are summarised below. A full list of the findings and recommendations are included in this report. Classification of internal audit findings are detailed in Appendix 2.

	High	Medium	Low
Number of internal audit findings	-	5	2

These findings and recommendations were discussed with management who have accepted the findings and have agreed actions to address the recommendations.

Executive summary

Summary of internal audit findings

Ref #	Description of internal audit findings	Rating of internal audit findings			Target date
		High	Medium	Low	
1	Supplier selection: No formal documented supplier selection process exists at present within the operational services directorate.				December 2009
2	Independent evaluation: No independent challenge or input from another directorate or service exists during the tendering process.				December 2009
3	Validity of tenders: The contracting group have not defined within the tender proposal documents the period a proposal will remain valid for, where the design group has designated a 90 day period.				December 2009
4	Incomplete documentation: Testing of compliance with the tendering process highlighted a number of exceptions including incomplete checklists and documentation that could not be found.				December 2009
5	Delegation of authority: The head of service has no upper limit in terms of financial authority as long as the recommended tender is the lowest proposal.				December 2009
6	Risk assessment: The original project risk assessment completed during the capital justification process is not updated following appointment of the recommended supplier or contractor.				December 2009
7	Tendering process: Differing tendering processes are adopted by the design group and contracting group creating inconsistency in terms of approach. In addition, the £25,000 contract value threshold that stipulates when the detailed tendering process should be adopted is potentially inappropriate and does not allow for consideration of the potential contract values and associated risks to the Council.				December 2009

Internal audit findings to be actioned

1. Supplier selection

Rating of internal audit finding: Moderate

Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
<p>We identified from our discussions with management in the design group and contracting group that, at present, no formal supplier selection policies or procedures exist.</p> <p>The design group has detailed tender process guidelines and relevant documentation to support this process. However, we noted that there were no formally defined or set criteria for supplier selection to support determining which contractors are invited to tender for a particular project. In addition, we identified that suppliers invited to tender for contracting group projects are selected from a pre-approved list which consists of subcontractors used previously. By choosing from pre-approved lists the contracting group could potentially omit a subcontractor who could perform the task, but was not aware of the project as they had not been invited to tender.</p> <p>For both the design group and contracting group the Council needs to ensure transparency in their selection process and demonstrate that consideration has been given to all parties who are able and capable of completing the project. Currently, it may be difficult to evidence a formal and transparent process in both instances.</p>	<ol style="list-style-type: none"> 1. Management should consider formalising the supplier selection process for the design group to ensure defined criteria are used to select contractors to be invited to tender. The results of the evaluation process should be documented to ensure the process is transparent and to provide assurance to all parties that they were afforded equal consideration. 2. Management within the contracting group should consider periodically advertising an invite to contractors to apply for inclusion on a pre-tender list. This list will then identify contractors that are invited to tender depending upon the project. 	<p>Action: Agreed.</p> <p>Responsibility: Head of Roads and Amenity Services</p> <p>Target Date: December 2009</p>

2. Independent evaluation **Rating of internal audit finding: Low**

Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
<p>While the tendering process within the design group is formally documented within work instructions we identified that the evaluation of tenders returned is mainly conducted by the project engineer, with only significant issues highlighted to the principal engineer. Whilst testing identified no significant exceptions the involvement of an independent challenge point, possibly from another function, as part of tender evaluation, would strengthen the current process.</p> <p>A lack of independent challenge increases the possibility that factors impacting the wider Council or external economy might not be factored into decision making. In addition, currently there is no evidence of independent confirmation of compliance with tendering procedures.</p> <p>Independent parties can provide an oversight and challenge role allowing the Council to evidence the transparency and fairness of the processes adopted. It also promotes learning and added value to the wider Council and other service lines.</p>	<p>Management should consider introducing an independent challenge point for the recommendations and approvals generated through the tendering processes.</p>	<p>Action: Agreed.</p> <p>Responsibility: Principal Engineer</p> <p>Target Date: December 2009</p>

3. Validity of tenders		Rating of internal audit finding: Low
Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
<p>In discussions with management, we found that the contracting group does not state within the tender documents passed to suppliers how long proposals shall remain valid. The design group has a valid period for tenders of 90 days which is included within tender proposal documentation.</p> <p>The absence of a validity period can lead to inconsistencies in the validity of prices submitted for a single project which make comparison potentially problematic.</p>	<p>The contracting group should consider establishing a validity period for each tender and incorporate this into the terms and conditions of all tender documentation.</p>	<p>Action: Agreed.</p> <p>Responsibility: Operations Manager</p> <p>Target Date: December 2009</p>

4. Incomplete documentation

Rating of internal audit finding: Medium

Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
<p>In order to test the tendering process we selected a sample of 12 contracts from projects currently ongoing within the roads and amenity services capital plan. The sample consisted of nine contracts with a value greater than £25,000 and three contracts with a value less than £25,000. We tested compliance against the tendering detailed work instructions.</p> <p>In terms of the contracts with values greater than £25,000 we identified only minor exceptions. From the nine contracts tested the following exceptions were identified:</p> <ul style="list-style-type: none"> • three instances where checklists were not completed in full, although tasks had been performed; and • two instances where a signed tender report authorising the recommended tenderer could not be located. <p>In terms of the contracts with values less than £25,000 we identified the following exceptions:</p> <ul style="list-style-type: none"> • no documented approval was evident for all three contracts that provided authorisation for the simplified tendering process to be adopted; and • two minor exceptions where tender action and tender return checklists were not completed in full. <p>Whilst these are minor exceptions they are defined process steps within the work instructions that outline the tendering process guidelines.</p>	<p>Management should review the processes, where by, compliance with tendering procedures within work instructions is confirmed on a continuous basis. This should incorporate an end of process check that all relevant documentation has been appropriately completed and retained. This could be captured within the final tender report and signed off to confirm that all relevant documentation and sign off's have been completed and retained.</p>	<p>Action: Agreed.</p> <p>Responsibility: Quality Manager</p> <p>Target Date: December 2009</p>

5. Delegation of authority

Rating of internal audit finding: Moderate

Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
<p>We noted that the Head of Service has unlimited authority to approve recommended contractors with the only exception being where the recommended contract value is not the lowest option and greater than £100,000.</p> <p>This creates a position that as long as the proposed tender is the lowest contract value the head of service has no upper limit in terms of the financial approval. This is not deemed to be a reasonable or appropriate financial control and a ceiling in terms of approval should be retained.</p> <p>A number of mitigating controls do exist such as budgetary controls and the requirement for legal services to issue acceptance letter for contracts greater than £100,000. (Legal services confirm the contract has been authorised by the head of service and that the appropriate terms and conditions are adopted).</p>	<p>Management should consider reviewing the existing delegation of authority and identify upper limits requiring an additional, or alternative, level of financial approval for all budget holders or members of the senior management team.</p>	<p>Action: Agreed.</p> <p>Responsibility: Head of Roads and Amenity Services</p> <p>Target Date: December 2009</p>

6. Risk assessment

Rating of internal audit finding: Moderate

Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
<p>Following discussion with the management team in the design group we identified that while risk is considered as part of the business case to support capital justifications it is not a factored into, or formally documented into, the tender evaluation or supplier approval process.</p> <p>This should be a factor that is continually evaluated during the life of a project, particularly at the stage of appointing a supplier to complete projects.</p>	<p>Management should update the original risk assessment completed during the capital justification process following the appointment of a contractor or supplier to deliver a project. This should be completed at the tender report stage and used to inform future project and implementation planning.</p>	<p>Action:</p> <p>Agreed. This will be introduced alongside the implementation of Prince2 (Project Management) principles.</p> <p>Responsibility:</p> <p>Operations Manager / Principal Engineers</p> <p>Target Date: December 2009</p>

7. Tendering process

Rating of internal audit finding: Medium

Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
<p>Following the completion of testing the design group contracts and subsequent discussions with the contracting group, we noted that the design group's tendering procedures were much more detailed than those followed by the contracting group, who adhered only to standing orders, which only provides guidance at a high level.</p> <p>The inconsistency in tendering procedures creates inefficiencies and increases the risk of differing standards being applied for the same process within the Council.</p> <p>The work instructions currently used by the design group define a detailed tendering process with multiple controls points and an associated audit trail. This process requires to be implemented for all contracts with values greater than £25,000. In context of the value of the capital projects that the operational service directorate manage, the £25,000 threshold to comply with the detailed work instructions may be inappropriate. The level of detail adopted may be an inefficient use of resources and does not match either the respective contract value or associated risks to the Council.</p>	<ol style="list-style-type: none"> 1. Management should consider standardising the tendering process adopted by both the contracting group and the design group to ensure consistency across the Council. 2. Management should consider amending the contract value threshold that triggers the detailed tendering process to be adopted to ensure it appropriately reflects the contract value and respective risks to the Council. 	<p>Action: Agreed.</p> <p>Responsibility: Operations Manager / Principal Engineers</p> <p>Target Date: December 2009</p>

Appendix 1 – Objective, scope and approach

As part of the 2008-09 internal audit plan, as approved by the audit committee of Argyll and Bute Council (“the Council”), an internal audit review of the capital contracts was performed in February and March 2009.

Objective

The objective of the review was to consider the processes and controls to manage capital contracts for roads and amenity services, with specific focus on those contracts classified as asset sustainability or service development.

Scope

Based on the objective outlined above, the scope of the review was to:

- consider whether contractors invited to tender for capital projects were selected in a fair and competitive process;
- consider the controls and processes to monitor the facilitation of tender issuance and return is adhered to;
- consider whether the evaluation of returned tenders is fair and consistent;
- consider whether appropriate approval of the appointed contractor for the Council’s projects is obtained;
- consider the controls and processes established to monitor compliance with local and national legislations;
- identify the processes to communicate to both successful and unsuccessful tenderers;
- identify the processes for tender documentation retention; and

- on a sample basis, test compliance with the identified policies and procedures.

Approach

The internal audit was conducted by holding discussions with key members of Council staff and considering available documentation. Key staff members with whom we held discussions included:

- Arthur McCulloch, Principal Engineer. Roads and Amenity Services
- Peter Ward, Principal Engineer. Roads and Amenity Services
- Graham Brown, Operations Manager
- Ruairaidh Graham, Technical Officer
- Alan Brough, Procurement Manager
- Iain Welsh, Project Manager
- Martin Gorrings, Operations Manager - Marine & Airports
- Donnie McLeod, Streetscene Manager

Appendix 2 – Classification of internal audit findings

The following 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 graded with management

Rating	Definition
High	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	Observations 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.