



Argyll and Bute Council

Contract management - Follow up Audit

July 2010

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1 Executive Summary

1.1 Introduction

As part of the 2007-08 audits, we reviewed the contract management of the Argyll Air Services project and identified a number of weaknesses in the Council's arrangements. Since then, the Council has significantly revised its contract management arrangements, particularly by adopting the Gateway model for feasibility and business. The purpose of this audit is to consider the Council's progress in implementing agreed action plan points in relation to new projects that have been processed under the Gateway model. Our audit was undertaken in partnership with internal audit and included a review of the Council's progress in implementing recommendations specific to the Argyll Air Services project.

1.2 Key findings

Our audit has confirmed that the Council has made significant improvements to its contract management procedures since our last review. In particular, we noted that the Gateway process has now been implemented and was followed for the five new projects included in our sample.

Of the 8 recommendations made in our 2007-08 report, five have now been fully implemented, two are not yet implemented, and one is no longer relevant. A full summary of progress is included at Appendix B.

We have two new recommendations in our action plan at Appendix A relating to the post completion review process:

- arrangements are in place for post completion reviews under the Gateway process, but the timing of such reviews is not made explicit in each project timetable.
- a post completion review should be completed for the Argyll Air Service project.

The Argyll Air Services project has encountered some difficulties during the year due to disruptions to air travel generally and the failure of the PSO contract provider, Highland Airlines. The Council has appointed a new provider, Hebridean Air Services, to run the services until the contract is due for retender in September 2010. We recommend that the Council completes the business plan for the airports, and carries out a post completion review of the project.

1.3 Way Forward

The findings and recommendations from our review are summarised in an Action Plan that accompanies this report in Appendix A. The Action Plan has been agreed with management and incorporates the management response to audit recommendations. Management should seek to ensure that the outstanding recommendations that have not been implemented within the specified timeframe are prioritised for completion.

1.4 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.

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 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.

Grant Thornton UK LLP
July 2010

2 Main findings

2.1 Introduction

As part of the 2007-08 audits, we reviewed the contract management arrangements in relation to the Argyll Air Services project. This was a large and complex capital project to reconstruct the three airports at Oban, Coll and Cononally to allow scheduled passenger flights to operate. Our review found a number of weaknesses in the Council's contract management arrangements which are summarised in Appendix B.

The Council has significantly revised its contract management arrangements since our last review. Our 2009-10 audit focussed on the Council's progress in implementing action plan points in relation to new projects that have been processed under the scheme. In addition, we considered the implementation of issues specific to the Argyll Air Services project that the Council are taking forward. Our work was planned and performed jointly with internal audit.

2.2 Projects reviewed

We chose a sample of 10 projects to audit, with five reviewed by Grant Thornton UK LLP and five by the Council's internal auditors.

Project	Details	Focus	Reviewed by
CHORD- Oban Bay/Harbour	Redevelopment of Oban Harbour	Business planning and contracting/financing	Grant Thornton UK LLP
CHORD- Campbeltown Kinloch Road Regeneration	Regeneration of housing and transport links in Campbeltown	Business planning and contracting/financing	Grant Thornton UK LLP
CHORD- Campbeltown THI	Redevelopment of key and historic buildings in Campbeltown	Business planning and contracting/financing	Grant Thornton UK LLP
Tobermory Early Years Unit	Construction of a new early year's unit.	Project management and monitoring/financing	Internal audit
Mull and Iona Progressive Care Centre	Construction of a new care centre	Project management and monitoring/financing	Internal audit
A818 Amenity Site Right Turning Lane	Proposal for road redevelopment	Project management and monitoring/financing	Internal audit
A849 Pennygheal Bridge, Mull	Proposal for a new bridge	Project management and monitoring/financing	Internal audit
Tarbert STP Facility	Construction of all weather sports facility in Tarbert	Project management and monitoring/financing	Internal audit

Project	Details	Focus	Reviewed by
Helensburgh Office Rationalisation	Proposal for a new office building in Helensburgh	Project management and monitoring/financing	Grant Thornton UK LLP
Helensburgh swimming pool re-development (new facility)	Proposal for a new swimming pool for Helensburgh	Business planning and contracting/financing	Grant Thornton UK LLP

2.3 Business planning and contracting

In February 2007, the Council agreed a new approach to weighting and scoring capital projects. This includes a "Gateway" review which considers projects against the Council's strategic objectives. Our review considered compliance with the Gateway procedures and the adequacy of risk assessments undertaken on the sampled projects. In addition, we considered the funding procedures and arrangements in place to monitor capital and revenue budgets.

Of the five projects that were analysed, we noted the following findings:

Project	Comments
CHORD- Oban Bay/Harbour	<p>Planning is in line with the Gateway model, with an Initial Business Case, Outline Business Case, Project Implementation Document, (PID) and Full Business Case produced.</p> <p>Risk assessment procedures are in place, with a risk register included in the PID and this is reviewed each month by the Board.</p>
CHORD- Campbeltown Kinloch Road Regeneration	<p>Planning is in line with the Gateway model, with in Initial Business Case, Outline Business, Project Implementation Document, (PID) and Full Business Case produced.</p> <p>Risk assessment procedures are in place, with a risk register included in the PID and this is reviewed each month by the Board.</p>
CHORD- Campbeltown THI	<p>Planning is in line with the Gateway model, with in Initial Business Case, Outline Business, Project Implementation Document, (PID) and Full Business Case produced.</p> <p>Risk assessment procedures are in place, with a risk register included in the PID and this is reviewed each month by the Board.</p>
Helensburgh Office Rationalisation	<p>Planning is in line with the Gateway model, with in Initial Business Case, Outline Business Case being produced. A revised outline business case is being developed due to external changes and factors influencing the project after the initial business case was produced.</p> <p>The project is currently not fully costed, and it is not clear if funding will be achieved in order to proceed with the project.</p>

Project	Comments
Helensburgh swimming pool redevelopment (new facility)	<p>Planning is in line with the Gateway model, with in Initial Business Case an Initial Business Plan developed, and an Outline Business Plan in progress.</p> <p>The project is currently not fully costed, and it is not clear if funding will be achieved in order to proceed with the project.</p>

Overall, we conclude that the Gateway process is now in place and is being implemented for new projects at the planning stage.

Tendering arrangements

A previous review by Internal Audit of the Argyll Air Services project noted that the Council complied with relevant EU and Council procurement regulations in tendering for the project. A number of minor recommendations were made on improving the documentation of the tendering procedures.

In 2009-10, internal audit carried out a further review of tendering procedures, through their audit of the contract to upgrade Helensburgh Swimming Pool. Their report *Review of tendering procedures* was issued in October 2009. The report noted one high risk recommendation to improve arrangements in relation to budgeting for projects.

2.4 Project management and monitoring

Internal audit reviewed the procedures in place to monitor and manage the financial and operational progress of the sampled projects, including any identified overruns.

Internal audit concluded that the Asset Management Strategic Board (AMSB) has achieved "significant progress" in the implementation of the Gateway approach. The projects reviewed all predated the Gateway project, however internal audit reported that they were satisfied that the influence of the Gateway approach in determining priorities and how cost may be more accurately assessed, could be seen in the review of these five projects.

Internal audit raised one finding which questioned whether an over spend in one project would have been identified in the Gateway process. The report recommends that the AMSB review the project in question to determine if the Gateway process would have identified and mitigated the over spend.

2.5 Post completion, financing and accountability

The Gateway procedures require a post completion review of major capital projects. This is a 2 stage process with the first stage taking place after the completion of the construction phase, and the second stage several years later.

Post completion reviews are the responsibility of the relevant head of service. The project manager will complete the new "project outcome review", which is a two stage process:

- Stage 1 will take place at the end of the construction phase, and will consist of a project outcome review submitted to the asset management board. This includes and outcome gateway checklist for the project, an analysis of the outcomes, and a review against benchmarks for the project

- Stage 2 is relevant for projects with ongoing benefits or risks (for example for an asset in use, savings actually achieved in operation will be compared to savings anticipated in business case). This review is anticipated to take place after the asset has been in use for a couple of years. The details of this process are still to be developed.

At this stage of the Gateway process, there are no projects that have reached the post completion review stage. We noted that the timetables for each project specify completion dates, but do not indicate when a post completion review will take place.

Action plan point 1

2.6 Argyll Air Services Project

Our audit considered the following areas, specific to the Argyll Air Services project:

- passenger numbers
- accounting and budgetary arrangements
- business plan development
- post completion review
- operation of the PSO contract.

Passenger numbers

In our 2007-08 report, we noted that the passenger numbers for the airport services were less than Council's projections. At the time of our review however, it was too early to determine if passenger demand for the service would meet expectations.

Since then, the total number of passengers using the services continues to be less than the projected figures. The figures for 2009 show total passengers of 2,291 compared to the Council's forecast of 2,315 and 2,779 quoted in the original business plan. However, we note that there were several mitigating factors impacting on air travel generally during the period under review, including severe weather disruption. In 2010, UK wide restrictions on the aviation industry caused by volcanic ash from the eruption of Eyjafjallajökull in Iceland, effected passenger numbers. In addition, services were disrupted by the financial problems and subsequent administration of Highland Airlines.

The Council should continue to review the projected passenger numbers as part of the development of the business plan and as part of the retender of the PSO contract.

Appendix B- point 6

Accounting and budgetary arrangements

We previously recommended that the Council consider preparing separate management accounts for Argyll Air Services in order to improve budget setting and monitoring arrangements. However, the Council believes that the current arrangements are adequate for the purposes of forming and monitoring a budget for the airports. Our follow up audit considered the current accounting and budgeting arrangements, and the current financial performance of the airports.

Our review of the budget position as at February 2010 highlighted that the airports were expected to record a small overspend of £10,000 (1.2%) in the budgeted position for the year 2009-10.

Area	Budget £'000	Forecast outturn £'000	Forecast variance £'000
Income	(947)	(936)	(11)
Employee expenses	592	574	18
Premises	133	124	9
Supplies and Services	143	159	(16)
Transport	338	358	(20)
Third party payments	556	546	10
Net position	815	825	(10)

Source: Argyll and Bute Council February budget monitoring reports

Our 2009-10 audit found that budget reports are produced monthly and reviewed. This is in line with the general budget monitoring process adopted across the Council. Overall, arrangements were considered satisfactory based on the decision to operate the airports within the existing Council structure.

Development of a business plan

We previously recommended that the Council review the future development of the airports, and consider the best structure for their operation, including evaluation of the options to sell or subcontract the running of the airports.

Since our previous report, the Council has decided to retain the airports. The Council had previously agreed to prepare a business plan for the airports as part of the 2010-11 budget setting process; however this has not yet been done due to the failure of Highland Airlines and the upcoming re-tender of the PSO contract.

Appendix B- point 8

Post completion review of the project

The Council has not yet initiated a post completion review of the Argyll Air Services project.

A post completion review should be carried out in order to assess the success of the project against initial benchmarks. This should follow the 2 stage approach as set out in the new Capital Programme Planning & Management Guidelines outlined above. The upcoming re-tender of the PSO contract offers an ideal opportunity to carry out a post completion review.

Action plan point 2

Operation of the PSO contract

At the time of planning our review, press reports were indicating that Highland Airlines (who operate the Public Service Obligation contract) were in financial difficulties and were no longer accepting bookings for its routes. The airline later reported that it has secured some new funding, but continued to place restrictions on future bookings for routes between Oban and the islands.

Since then, Highland Airlines have entered administration, and all services from Oban and the islands were subsequently cancelled. The Council began to develop a contingency plan

to deal with the cancellation of flights at Oban and the islands. The Council started negotiations with other providers and alternative arrangements were put in place to maintain lifeline services.

The Council has now appointed a new airline to operate the PSO contract- Hebridean Air Service. This arrangement will stay in place until the contract is retendered in September 2010. In addition, a new service from Oban to Islay Airport is now in operation.

A Action plan

No	Finding	Risk	Recommendation	Management Response	Implementation Date
1	<p>Post completion reviews</p> <p>The current timetables for the Gateway process do not specify when the post completion review will take place.</p> <p>There is a risk that post completion reviews will not be completed in a timely manner, compromising the value of the return from such reviews.</p>	Medium	Each project is different and therefore the OBC should set a timetable within the Project Plan. The AMSB should ensure compliance	Accepted	Immediate
2	<p>Post completion reviews</p> <p>A post completion review has not yet been started for the Argyll Air Project.</p>	Medium	The Council should initiate a post completion review for the Argyll Air Service project, linked into the retender for the PSO contract.	The Council will initiate a post completion review for the Argyll Air Service project linked to the retender of the PSO contract	31 March 2011

B Progress of implementation of contract management action plan

No	Finding and original risk rating	Recommendation	Management Response and implementation date	Update as at June 2010
1	<p>The Council does not always adequately document the decision making process at key stages of the contract management process.</p> <p>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.</p> <p>Risk: Medium</p>	<p>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.</p>	<p>This recommendation 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</p>	Implemented
2	<p>There was no evidence that preliminary studies completed for the Project in 1998 had been updated to ensure key assumptions continued to apply.</p> <p>Risk: High</p>	<p>The Council should ensure business planning documents are kept up to date and remain relevant throughout the project life.</p>	<p>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.</p>	Implemented
3	<p>A detailed assessment of the risks associated with the Project was not undertaken prior to commencement of the works.</p> <p>Risk: High</p>	<p>All major capital projects should be subject to detailed risk management procedures, including a risk assessment prior to commencement of the works.</p>	<p>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.</p>	Implemented
4	<p>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</p>	<p>The Council should ensure there is adequate evidence to support estimates incorporated in capital projects.</p>	<p>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</p>	Implemented

No	Finding and original risk rating	Recommendation	Management Response and implementation date	Update as at June 2010
	budget. Risk: High		contingency by its nature is always going to be an estimate	
5	A number of issues added to the final cost of the project which the Council should have identified and addressed in advance. Risk: Medium	The Council should ensure contract preparation arrangements adequately identify all material costs likely to be incurred for major contracts.	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.	Implemented
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. Risk: Medium	The Council should plan to review existing projections for passenger numbers at its airports to ensure the original business model continues to be sustainable.	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. 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.	Ongoing Passenger figures are slightly below forecasts for 2009 and 2010 to date. There have been some extra-ordinary events that have impacted the aviation industry including the volcanic ash disruption, and severe winter weather in 2009/10.

No	Finding and original risk rating	Recommendation	Management Response and implementation date	Update as at June 2010
			<p>Marine and Airfields Manager with Head of Roads and Amenity Services</p> <p>January 2010</p>	<p>The re-tender and production of the business plan will see revised passenger projections calculated.</p>
7	<p>Argyll Air Services operates separately from the Council's main activities and partly on a commercial basis.</p> <p>Risk: Medium</p>	<p>The Council should consider preparing separate management accounts for Argyll Air Services to improve budget setting and monitoring arrangements.</p>	<p>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.</p>	<p>No longer relevant</p> <p>The Council continue to account for the airports within Roads and Amenity Services.</p>
8	<p>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> <p>Risk: Medium</p>	<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>	<p>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> <p>Marine and Airfields Manager with Head of Roads and Amenity Services.</p>	<p>Not yet implemented</p> <p>The Council is in the process of developing a business plan for the airports.</p> <p>Completion of the business plan was delayed by the failure of the PSO operator, Highland Airways, and is now</p>

No	Finding and original risk rating	Recommendation	Management Response and implementation date	Update as at June 2010
			Budget process for 2010/11	expected to be implemented following the re-tender of the PSO contract in September 2010.



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