Audit Report Highway Maintenance Contract September 2005

Confidential



PLANNING, TRANSPORT AND ECONOMIC STRATEGY

Highway Maintenance Contract

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1. Introduction

- 1.1 This report outlines the results of a review of the County Council's seven years partnering agreement with Carillion to provide highways maintenance services.
- 1.2 A Best Value Review of the management of routine and structural maintenance was undertaken in 2001. The need to have contracts that could demonstrate continuous improvement was identified as an area for improvement. The outcome of this review led to a strategy being developed for a new highway maintenance contract that was agreed by Cabinet in September 2001.
- 1.3 The contract was awarded to Carillion in February 2004 and commenced on the 5th May 2004, using the NEC Engineering and Construction Contract, 2nd Edition, Option C (target costs with activity schedules). The key to successful operation of the contract is as stated in the first core clause of the contract: "The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract in a spirit of mutual trust and cooperation."
- 1.4 The contract covers 12 activity areas. A target price is drawn up for each activity based upon the agreed work programme. The total target cost of the contract is made up of the target for each of the activities, plus preliminary costs. In addition a fee of 5% of the total target cost is paid to cover the contractor's Headquarters costs and profit margin.
- 1.5 The total budget cost for the contract for 2004/05 was initially set at £14.8m in May 2004. However, as the programme of scheduled work was later reduced for a number of the activities, the total budget cost was reduced to £14.1m in January 2005. Under the partnering arrangements if the actual costs for the whole contract are above the target cost, then the overspend is shared between WCC and Carillion according to a pre-determined scale. The latest financial position for 2004/05 is stated in the Envelope of Liability Schedule (dated 13/07/2005) as follows:

	Range		
	Minimum	Maximum	
Actual costs *	£14.5m	£15.3m	
Target costs	£13.1m	£14.2m	
(Pain) / Gain amount	(£ 0.3m)	(£ 0.1m)	
* Unallocated costs	£0.4m	£0.5m	
(included in actual costs)			

1.6 A summary of this report will be included in the next appropriate quarterly internal audit report to the Standards Committee. Progress on implementing recommendations will also be reported periodically to the Committee.

2. Objectives of the Audit

- 2.1 The review has been carried out in two parts.
 - A specialist in contract audit examined the procurement process used to award the contract, determined the extent to which it represented best practice and examined the contractual arrangements entered into.
 - The second part of the review evaluated the arrangements for managing the contract. This primarily concentrated on the financial controls in place.

This report is based upon a series of meetings with staff in PTES and Carillion involved in the operation of the contract and limited testing. Further, more detailed, audit work is envisaged during 2005/06.

3. Summary and Overall Conclusions

- 3.1 We consider that there was some blurring of the processes between prequalification and tender. Pre-qualification should stand alone in determining those contractors that have the financial and technical capacity to fulfil the contract. It is not common practice to take forward information that has been obtained at the pre-qualification stage to the tender stage.
- 3.2 We were concerned that a full financial assessment was not undertaken at pre-qualification with the evaluation report acknowledging that further work would need to be undertaken on some contractors at tender evaluation. EC procedures do not allow for contractors to fail at tender something they have previously passed at pre-qualification. Financial pre-qualification should provide a list of potential tenderers who have the financial capacity to deliver the contract; this is a "pass or fail" issue and there are no grey areas.
- 3.3 Overall, we concluded that the assessments were carried out in a satisfactory manner and that sufficient records have been retained that would withstand detailed scrutiny. We are satisfied that all candidates were treated equally and fairly, and found that generally procedures followed demonstrated accountability.
- 3.4 The arrangements for open book accounting have been slow to develop and there are acknowledged difficulties with the current arrangements that has led to some suspicion and a return to traditional adversarial behaviour. We consider that one of the key reasons for this is the lack of a start up workshop involving representatives from all of the parties to this contract. Issues such as general lack of understanding of this form of contract and unclear roles and responsibilities should have been addressed at this stage. This would have provided the clear vision and the high level objectives for the partnering arrangement and provided an action plan to take the contract forward.
- 3.5 As a result of unclear roles and responsibilities PTES are experiencing significant difficulties in operating the contract. There is no clear management

structure and confusion over the decision-making process. This has resulted in incomplete procedures and controls. There are communication problems within PTES and between PTES and Carillion.

These weaknesses have resulted in significant failings in the financial management of the contract in the following areas:

3.5.1 Targets

We are not clear about how the targets were originally devised and the process for determining and agreeing subsequent changes. The fixing of target prices is fundamental to this type of contract and robust procedures are essential. Again these processes should have been determined during an initial partnering workshop. It is essential that robust procedures are now implemented for 2005/6 and that PTES can demonstrate how targets are arrived at.

3.5.2 Open Book Accounting

The extent to which any partnering arrangement can successfully demonstrate probity and accountability relies on the establishment of robust open book arrangements at the outset. This is particularly the case for partnering exercises that involve compilation of target costs for each activity, the processing of payments based on actual expenditure, and the agreement of extra costs in respect of compensation events. Under the terms of the contract Carillion keeps:

- Accounts of payments of actual cost;
- Records which show that the payments have been made;
- Records of communications and calculations relating to assessment of compensation events for Subcontractors; and
- Other accounts and records as stated in the Works Information.

WCC are allowed to inspect the accounts and records that Carillion are required to keep. However, open book accounting is not simply about "going through the books to check up on the contractor". It has to be operated in the spirit of partnering. However, at the time of the audit the arrangements for open book accounting were very much in a state of development with much suspicion on the Council's side and a general lack of communication.

SCRAPS is not an accounting system and consequently it has a number of weaknesses. In particular, it cannot provide an audit trail and therefore costs cannot be traced back to original records. Also costs should be able to be reconciled across SCRAPS, but this has not been possible. We could not confirm the integrity of the SCRAPS system. We are concerned that costs may be incorrectly stated and the system may be double counting, leading to increased costs being paid. Arising from detailed testing we have some concerns about the level of costs being charged by sub-contractors and the number of hours appearing on timesheets. Both Carillion and PTES need to be confident about the integrity and suitability of cost recording systems and it

may be necessary to consider the addition of an independent cost consultant to the team, or whether it would be sufficient to rely on a suitable assurance statement from Carillion's external auditors regarding SCRAPS.

There is little evidence of a partnering approach being adopted to deal with issues and any move away from a traditional approach to the contractor. There is a distinct lack of understanding of partnering, how the NEC contract works and roles and responsibilities within the new arrangements. These issues could have been averted had a start up workshop been held. We are particularly concerned that PTES Finance was not sufficiently engaged during the tendering and mobilisation periods.

3.5.3 Performance Monitoring

Comprehensive key performance indicators were developed during the procurement process. KPIs do not have any bearing on target price, they are there to indicate whether the key success factors of the contract have been achieved. If performance targets are achieved Carillion receive a year end bonus conversely if they are not achieved WCC are entitled to a "negative bonus". The monitoring of KPIs is essential to ensure that the contract's key objective of continuous improvement is achieved. However, formal performance monitoring has only recently started although specified in the contract to commence three months after the starting date. It is essential that a robust process for setting and monitoring KPIs is implemented.

- 3.6 The audit has identified a significant number of weaknesses in control that is exposing the Authority to an unacceptable level of financial risk. The many issues identified during this review need to be addressed urgently to reduce the Authority's exposure to risk. In particular, the general lack of understanding of this form of contract and unclear roles and responsibilities need to be addressed by holding a partnering workshop. This should aim to develop a strategic vision and high-level objectives for the partnering arrangement. It is important that sound processes are put in place for future years and that the target setting and performance monitoring processes for 2005/6 are robust.
- 3.7 More generally, there are lessons that need to be considered in any future procurement exercises of this type. We therefore make a number of recommendations regarding the way forward for future procurement exercises within the County Council and that these need to be addressed at a suitably high-level, and on a strategic and corporate basis. In particular we direct attention to the documents produced by Constructing Excellence called "Rethinking Construction in Local Government ten key issues and how to address them" which provide the current thinking on best practice and fully supports the views that we have expressed.

For this purpose the Action Plan is in two parts; one to cover the recommendations relating to future procurement exercises and the other to cover issues specific to the contract with Carillion.

3.8 <u>Recommendation</u>

A strategic vision for the future operation of the contract should be developed at a workshop attended by all parties. The workshop should produce a partnering charter, agreed by all, detailing the objectives of the contract and an action plan to move the contract forward and achieve these objectives.

More detailed findings and supporting recommendations are contained in the appendices.

ACTION PLAN

Part 1 - RECOMMENDATIONS RELATING TO FUTURE PROCUREMENT EXERCISES

1. Fundamental issues

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
01	A corporate policy on the start-up process that should be adopted for partnering arrangements should be developed. This should provide for start-up workshops to be attended by all parties to develop a strategic vision for the operation of the contract. The workshop should produce a partnering charter, agreed by all, detailing the objectives of the contract and an action plan to move the contract forward and achieve these objectives.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006
02	Procurement Process: Guidance should be developed on the use of quality price evaluation models that explains the rationale, the implications of the approach and provides direction on determining appropriate quality price evaluation ratios.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006
03	For future exercises a complete record of the procurement process should be maintained. The receipt of expressions of interest and the receipt and opening of PQQs should be formally recorded, dated and signed.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006

2. Significant Issues

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
04	PQQ Evaluation: Evaluation criteria and methodology should be determined and agreed prior to the issue of the Contract Notice, as a minimum it should be agreed prior to the issue of the PQQs.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006
05	Interviews and 'reality checks' should not normally be considered or form part of pre-qualification.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006
06	The financial evaluation of the PQQ should result in a pass or fail with only financially sound contractors being invited to tender.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006
07	The amount of detail requested by PQQs should be carefully assessed. Only information that is necessary to enable submissions to be assessed in accordance with the pre-defined criteria need be requested.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
08	All reports should be dated, the author identified and	Agreed. The need for corporate	Assistant	31 March 2006
	minutes of decision-making meetings kept.	guidance will be considered during the	Chief	
		review of contract standing orders and	Executive	
		the development of the procurement	and County	
		toolkit planned for 2005/6.	Solicitor	
09	All documentation relevant to the PQQ evaluation	Agreed. The need for corporate	Assistant	31 March 2006
	should be held together.	guidance will be considered during the	Chief	
		review of contract standing orders and	Executive	
		the development of the procurement	and County	
		toolkit planned for 2005/6.	Solicitor	
10	Tender evaluation:	Agreed. The need for corporate	Assistant	31 March 2006
	Where a minimum quality standard is mentioned as	guidance will be considered during the	Chief	
	part of the process this should be documented and	review of contract standing orders and	Executive	
	adhered to.	the development of the procurement	and County	
		toolkit planned for 2005/6.	Solicitor	
11	Where tenders are to be evaluated on quality as well	Agreed. The need for corporate	Assistant	31 March 2006
	as price the tender documents should detail the ratio	guidance will be considered during the	Chief	
	and the weightings to be applied to each evaluation	review of contract standing orders and	Executive	
	criterion.	the development of the procurement	and County	
		toolkit planned for 2005/6.	Solicitor	
12	There should be a clear distinction between pre-	Agreed. The need for corporate	Assistant	31 March 2006
	qualification and tender. Marks obtained during the	guidance will be considered during the	Chief	
	pre-qualification stage should not be carried forward	review of contract standing orders and	Executive	
	to form part of the tender process.	the development of the procurement	and County	
		toolkit planned for 2005/6.	Solicitor	

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
13	Guidance on the use of consensus scoring should be developed as it could weaken the transparency and accountability of the evaluation process if not carefully carried out.	Agreed. The need for corporate guidance will be considered during the review of contract standing orders and the development of the procurement toolkit planned for 2005/6.	Assistant Chief Executive and County Solicitor	31 March 2006

ACTION PLAN

Part 2 - RECOMMENDATIONS RELATING SPECIFICALLY TO THE HIGHWAYS MAINTENANCE CONTRACT

1. Fundamental issues

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
01	A strategic vision for the future operation of the contract should be developed at a workshop attended by all parties. The workshop should produce a partnering charter, agreed by all, detailing the objectives of the contract and an action plan to move the contract forward and achieve these objectives.	Seminars have taken place on 16 th May and 7 th June 2005, facilitated by Neil Jarrett of CWC, Warwick University. These were attended by leading managers from WCC and Carillion. Actions to move forward continuous improvement were agreed at the meetings.	Partnering Board	
02	Target costs: Effective budget monitoring arrangements should be introduced.	A joint Project Board chaired by David Lynn, comprising David Tong, Carillion L.A.Regional Manager, and financial representatives from both partners has produced an action plan to resolve address the problems identified within the financial reporting system. Three new KPIs are being introduced to monitor financial management: • Percentage of deadlines met	David Lynn, Head of Warwickshire Engineering	31/10/2005

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
		 covers submission of invoice, and provision of forecast outturn and forecast pain/gain (target 95%) Unallocated, misallocated and recurring disallowed costs to be resolved before next but one assessment (target 90%) A KPI to reflect achievement of the outputs of the new Project Board (this will need to be determined once terms of reference, objectives and outputs have been agreed). 		
03	The 2005/06 target prices should be negotiated robustly.	The process that has been adopted for agreeing targets for 2005/06 has been strictly in accordance with the contract (Contract Data Part 1Z2.22) and a complete audit trail showing the relationship between Year 1 and Year 2 targets will be maintained by the Project Manager.	Peter Samwell, Policy Manager	30/09/05
04	Open Book arrangements: Finance meetings are held in the spirit of partnering with both client and contractor present.	The joint Project Board is engaged to resolve finance issues in the spirit of partnering. Also a	David Lynn, Head of Warwickshire	31/10/2005

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
		representative of PTES Financial Services is now attending Core Group, in order to ensure that financial matters are properly addressed at management level.	Engineering	
05	That roles and responsibilities of PTES are clearly defined and that effort is put into developing a sound working relationship between the Council and Carillion.	These roles and responsibilities are set out in the guidance produced by the County Treasurer's Project Team and incorporated in the Contract Management Manual, which was issued to all staff. Acknowledge that these roles and responsibilities need reinforcing with staff and the guidance will need reviewing in the light of work carried out by the Project Board. A review of Area Client activities has been undertaken which has commissioned the production of an operation procedures manual for area client staff.	Core Group Neil Clark, Operations Manager	30/09/05
06	A suitable method for the effective use of open-book accounting and the high-level effective monitoring of costs should be devised.	Ditto as above but higher level monitoring is being developed through the joint Project Board. Introduction of financial report, Year 2 forecast of spend against	David Lynn, Head of Warwickshire Engineering	31/10/2005

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
		budget, to the Core Group on a monthly basis. Carillion have commissioned an independent financial advisor, to look at the issues within the financial accounting system under the guidance of the joint Project Board.		
07	Independent assurance should be requested of the integrity of SCRAPS.	The PTES Project Manager has been tasked with asking the Carillion Contract Manager for independent verification and assurance of the integrity of the SCRAPS system from Carillion's external auditors.	Peter Samwell, Policy Manager	30/09/05
08	PTES should ensure that there is no double counting of costs in SCRAPS.	Agreed	Peter Samwell, Policy Manager	30/09/05
09	Performance monitoring: A robust process should be developed for setting and monitoring KPIs as the basis for continuous improvement.	Agreed. The process is continually being developed to best reflect aspects of service delivery both financial and operational. Majority of targets now agreed and measurement now being undertaken.	Partnering Board	30/09/2005

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
10	Labour costs: Excessive working time and the treatment of idle time should be resolved with Carillion.	Currently operatives can sign a derogation to exclude them from the Working time Directive and most have. Carillion do have their own guidance on working hours, that a person must not work more than 120 hours in any two week period and this must include two 24 hour periods of non working. A daily work record is being introduced to record and monitor lost time. PTES consider that nevertheless they have a moral duty to ensure that Carillion is operating as a responsible employer in terms of the Working Time Directive.	Core Group	30/09/05
		A working group has now been established to address labour rates and labour overheads. A detailed proposal for the management of labour costs using overhead accounts is being prepared and agreement imminent. Internal Audit will be consulted on the planned	Jim James, Project Manager	30/09/2005

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
		approach.		
11	The effective monitoring of sub-contractor costs should be resolved with Carillion.	Again this is another issue to be addressed by the joint Project Board	David Lynn, Head of Warwickshire Engineering	31/10/2005
12	Material, plant and other costs: The effective monitoring of material and plant costs and the treatment of idle plant time should be ensured.	Agreed. A review of the monitoring of vehicle and plant costs has commenced with a proposal to treat vehicles and plant in a similar way to labour costs.	Jim James, Project Manager	30/09/2005
13	Overstated and unallocated costs should be resolved with Carillion.	Agreed Unallocated costs for 2004/05 have been resolved as part of the year-end processes. Action taken to reduce level of unallocated costs has been successful, current position unallocated costs Year 2 to date is £44,000.	Peter Samwell, Policy Manager	30/09/2005

2. Significant issues

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
14	Procurement Process All records relating to the procurement process should be held on file in one place.	Agreed. It is true that working papers appertaining to the evaluation of quality submissions by individual members of evaluation panels have not been kept centrally.	Peter Samwell, Policy Manager	30/09/05

3. Merits Attention

Ref	Recommendation	Agreed Action	Responsible Officer	Implementation date
15	All future reports should be dated, the author identified and minutes of decision-making meetings kept.	Agreed	Peter Samwell, Policy Manager	30/09/05

Detailed findings relating to the procurement process

1 Background

- 1.1 A Best Value Review of the management of routine and structural maintenance was undertaken in 2001. The need to have contracts that could demonstrate continuous improvement was identified as an area for improvement. The strategy for a new highway maintenance contract was agreed by Cabinet in September 2001.
- 1.2 A Preliminary Information Memorandum (PIM) and Pre Qualification Questionnaire (PQQ) were sent to the thirty one organisations that responded to the OJEC Notice that was published June 2002. Thirteen completed PQQs were received and evaluated by the evaluation panel. The top nine contractors were invited to tender. Three contractors withdrew at this stage and the remaining six were all asked to provide a full tender for the contract. Tender documents which included both quality and price elements were issued on the 16th May 2003.
- 1.3 During this period Price Waterhouse Coopers were asked to undertake a review of the procurement process and consider the tender evaluation process that had been developed and agreed by the tender evaluation team. This produced a slight delay to the process with the date for receipt of tenders being extended to the 12th August 2003. The key outcome of this report was that the quality price ratio was amended to 60:40.
- 1.4 The quality submissions were undertaken by the evaluation team, following which presentations were held. All six contractors were deemed to have met the minimum quality standard and all financial bids were opened. The final results of the assessment process are detailed below:

	TENDER	FINANCIAL		QUALITY		OVERALL	
	PRICE (Conforming tender)	% (Out of 40.00)	RANKING	% (Out of 60.00)	RANKING	% (Out of 100.00)	RANKING
Carillion	13,597,202.42	36.2	4	60.0	1	96.2	1
Alfred McAlpine	12,551,659.99	39.4	2	53.5	2	92.9	2
Raynesway	12,364,293.17	40.0	1	49.0	3	89.0	3
Edmund Nuttall	13,090,997.95	37.6	3	40.1	4	77.7	4
Associated WARCO	14,543,204.26	32.9	5	39.8	5	72.7	5
Colas	14,810,611.78	32.0	6	36.5	6	68.5	6

1.5 The contract was awarded to Carillion who were informed by letter of acceptance dated 11th February 2004. The contract commenced on the 5th May 2004, using the Engineering and Construction Contract, Option C.

2. Quality Price ratio

- 2.1 One of the key features of this contract was the evaluation of quality in addition to price. This recognised the fact that any selection process based purely on lowest price does not necessarily secure best value. The process of selection by quality as well as price is based on recording and measuring subjective judgements in accordance with a pre-defined decision making evaluation model. This then provides a process by which probity and accountability can be demonstrated by providing a clear audit trail.
- 2.2 Our examination of the process by which the quality price ratio was developed demonstrates that, in accordance with best practice, a tender evaluation team was established and the determination of the quality price ratio of 60:30:10, quality:price:best value was being considered.
- 2.3 However, we consider that the possible agreement of a three way quality price ratio demonstrates a failure to fully appreciate the rationale for adopting a quality price evaluation methodology. This is borne out by our examination of the files held by County Highways, which underline the confusion that the best value element caused and that there was much debate regarding the evaluation methodology to be applied to this final 10%.

PTES advise that the debate was still ongoing when PWC reported and at that point the 10% was being considered by the County Solicitor and the County Treasurer only as a fall back to be used in limited circumstances if the evaluation process disclosed some flaw in the marking system.

PTES are also of the view that consideration of a three way ratio does not demonstrate a failure to appreciate fully the rationale for adopting a quality price evaluation methodology. They consider that what it demonstrates is a proper degree of caution as to whether the scoring matrix will necessarily yield the correct result in a very complex procurement scenario.

- 2.4 There was a clear reluctance to accept that by applying scores for both quality and price the tender that represented the best value to the council would be chosen. It was feared that the following scenarios might occur:
 - a combination of very high quality score and high price might win and the council could not afford it
 - a combination of average quality score and a very low price could win resulting in a low quality service, or
 - a combination of high quality and low price could win with the contractor being unable to afford the service promised.

- 2.5 The consequence of this confusion is that the evaluation process was unduly complicated; with the PWC review being undertaken and the decision finally being taken that a quality price ratio of 60:40 would be adopted. What should have been acknowledged at the outset was that quality had not been part of the culture of evaluating tenders and the council was starting with a historical quality price ratio of 0:100. The move to a ratio of 60:40 represented a major change in emphasis while only finite funds remained available.
- 2.6 The method of determining quality/price ratios has evolved over more than the last decade and current best practice guidance is stated at operational issue 1.2 within the Constructing Excellence publication. We would stress that this approach has been used successfully in hundreds of procurement exercises throughout the UK for many years.

2.7 <u>Recommendation</u>

• We recommend that guidance is developed on the use of quality price evaluation models that explains the rationale, the implications of the approach and provides direction on determining appropriate quality price evaluation ratios.

3. Issue of EC Notices and Receipt of Expressions of Interest and issue of Pre Qualification Questionnaires

- 3.1 We confirmed that the required notice was placed in OJEC on the 20th June 2002. We confirmed that the notice contained sufficient information, and allowed respondents more than the minimum 5 weeks required to respond. The nature of the proposed working arrangements i.e. collaborative working, continuous improvement, target setting and the use of performance indicators were clearly stated.
- 3.2 A record of expressions of interest was found on file, which represents a prime record in defending any claims of malpractice by aggrieved organisations. The record confirmed that 31 expressions of interest had been received but did not record when the expressions of interest were received or when the PQQs were despatched. Copy letters showed that 25 PQQs had been issued, though 3 of the copy letters were dated incorrectly. Thirteen PQQs were returned. However the records provided do not confirm that the PQQs were received in time. Two of the PQQs had been dated by the companies on the closing date, though it is likely that the PQQs were hand delivered. Packaging for the PQQs may have been dated and signed at the time but these were no longer held, so this could not be confirmed. The record also does not provide evidence of the date the PQQs were opened and by whom.

3.3 <u>Recommendation</u>

• For future tendering exercises, complete records must be maintained and held on file. Entries relating the receipt of expressions of interest, receipt of PQQs and opening of PQQs should be formally recorded, dated and signed.

4. **Pre-Qualification**

4.1 Pre-qualification is the process of assessing potential tenderers for their general skills and competence and to establish their suitability to undertake given types of work within predetermined ranges of value. It is intended to ensure that contractors that are invited to tender are capable of performing to the required standard, tender lists comprise a comparable group of tenderers of appropriate standing and with established skill, integrity, responsibility and competence. We examined the format and content of the Preliminary Information Memorandum and the Pre Qualification Questionnaire, and the evaluation methodology and processes to determine the extent to which they reflected best practice.

Preliminary Information Memorandum (PIM)

- 4.2 We examined the PIM that was issued with the pre-qualification questionnaire and found that it provided a comprehensive overview of the scope and nature of the works and the type of contract being offered. Contractors were informed that selection would be based on other criteria as well as price, although the other criteria were not laid down in the PIM.
- 4.3 The PIM appears to be sending out mixed messages; it advocates a 'partnership concept' but presents contractors with a number of constraints which limit the potential for innovation in delivery of the service. For example the organisational and geographical positioning of the area teams, the central management of structural maintenance, drainage, street lighting, policy and monitoring. Generally, however, we consider that the PIM provided potential contractors with a good overview of the proposed contract and working arrangements. We would have liked to have seen some reference to the quality price ratio that was to be applied and ideally information on the quality evaluation criteria should have been included.

Pre Qualification Questionnaire (PQQ)

4.4 We confirmed that the PQQ was compiled in consultation with all interested parties, i.e. finance, health and safety etc. The PQQ evaluation process was determined prior to receipt of the completed PQQs, but not as best practice recommends prior to the issue of the contract notice. In addition the PQQ evaluation criteria were not agreed prior to the issue of the PQQs. Proper planning will ensure that evaluation methodologies are finalised before the issue of a contract notice or issue of PQQs. We consider that as a consequence of this the PQQ for this contract requested an excessive level of detail from prospective contractors that would have been better suited to

tender stage. The risk is that applicants may be put off from applying due to the effort that would be involved at an early stage of the process.

PTES advise that all information was used. They had required sufficient information to enable them to compare candidates when shortlisting, if that proved necessary, and the PQQ was scrutinised through the Gateway process. Legal Services' view is that the amount of information requested was not disproportionate to the size of the contract.

Responsibility for evaluating the PQQ responses was clearly allocated to specific officers and specialist staff were used for IT and Health and Safety.

Evaluation methodology

4.5 A detailed paper on the PQQ evaluation criteria was produced and it is clear that the purpose of the PQQ was clearly understood at this stage. At this stage contractors could be eliminated if they failed to meet the 'required minimum standards' as adjudged by the authority'. However our discussions with officers involved in the evaluation process failed to identify what the required minimum standards were.

PTES explained that they had found it almost impossible to set a score that expressed a minimum standard but accept that they could have produced more guidance as to the criteria.

Financial Evaluation of the PQQ

- 4.6 A report was produced detailing the results of the financial evaluation with contractors divided into those assessed as financially secure, those where a holding company guarantee was considered necessary or further investigation required as part of final tender evaluation and companies not found capable of delivering the contract. The report concluded that no company needed to be ruled out from a financial point of view.
- 4.7 We are concerned that in addition to this conclusion it was acknowledged that further work would be required in some cases to establish the financial suitability to undertake a contract of this type and complexity. The PQQ evaluation should establish which firms are capable of delivering the contract and reject those that cannot at an early stage. PTES advise that the reasoning behind this decision was that because of the lengthy tendering process it was useful to keep their options open as the construction industry at this time was undergoing some uncertainty, failed PFI's, etc. and financial fortunes of companies were subject to change. Legal Services agree with the general principle that questions determined at the PQQ stage should not be re-determined at the tender evaluation stage but point out that "it is a grave weakness in the process if this means that it is impermissible to check that there have been no changes of circumstances in relation to essential matters such as financial competence prior to award."

We stress that EC Procurement Directives and case law strictly prevents organisations from revisiting a PQQ assessment issue later in the process as it prohibits the rejection of firms at the second stage of tendering exercises on issues that have been previously assessed as being satisfactory.

The issues considered at PQQ and at tender evaluation stage need to be carefully considered and defined before a procurement process commences. This should ensure that there is no duplication, and that up to date information is only sought on key issues during the later stages. For example, it is perfectly in order to consider financial size (eg. turnover) and backing (eg. assets), together with checks as to bankruptcy, at PQQ stage, and then follow this up at tender evaluation stage with an examination of financial stability (eg liquidity). As well, by agreeing the evaluation criteria prior to issue a more focused PQQ can be developed. The main issue here is the need for corporate guidance on such matters.

PQQ Evaluation report

- 4.8 A report was produced on the evaluation of the PQQ, which had been undertaken by the Contract Preparation Group. The report details those officers that undertook the various aspects of the evaluation. The report provides comprehensive appendices on the scores by each officer for each area of the evaluation. The conclusion from this exercise was that the top nine contractors would be invited to tender. Prior to the withdrawal of 3 contractors it was intended that interviews and reality checks would be undertaken which would be used to refine the PQQ scores. Reality checks and interviews are normally left until the second stage of the process when potentially fewer applicants are involved.
- 4.9 The report on the financial evaluation of the PQQs recommended that there was no reason to exclude any of the contractors on financial grounds at this stage. However, Amey were excluded and there was nothing on the files examined that recorded the reasons for this. While the issues regarding Amey at this time are well known in the industry it would not necessarily be evident to senior officers or members, this exclusion should have been adequately documented. PTES were able to provide an undated, unsigned note, understood to have been written in February 2003, explaining why AMEY were to be excluded. However we have not seen a formal report or minutes of a meeting at which this decision was taken.

4.10 Recommendations

The PQQ process should provide a short list of the most suitable organisations from all those that expressed an interest in providing the services with a view to drawing up a short list of contractors to invite to tender. The criteria for selection should be established before inviting expressions of interest. To ensure that future procurement exercises fully reflect such best practice, consideration needs to be given to the following recommendations:

- Ideally evaluation criteria and methodology should be determined and agreed prior to the issue of the contract notice, as a minimum it should be agreed prior to the issue of the PQQs.
- Interviews and 'reality checks' should not be considered or form part of pre-qualification.
- The financial evaluation of the PQQ should result in a pass or fail with only financially sound contractors being invited to tender.
- When PQQs are compiled for future procurement exercises the amount of detail requested for each section should be carefully assessed. Only information that is necessary to enable submissions to be assessed in accordance with the pre-defined criteria need be requested.
- All reports should be dated, the author identified and minutes of decisionmaking meetings kept.
- All documentation relevant to the PQQ evaluation should be held together.

5. Tender Process

- 5.1 Originally the potential tenderers were to be advised how they had fared at PQQ and where they were ranked. They were informed that the first stage of the tender evaluation process would establish the five most economically advantageous tenderers who would then be invited to submit bids for the final stage of evaluation. We do not consider this good practice as it has the potential to deter contractors from tendering. In February 2003 9 of the 13 contractors were advised that they had met the minimum standard and that further evaluation would take place before invitations to tender were issued. The letters did not advise the contractors withdrew citing other commitments for their withdrawal.
- 5.2 Examination of the files held by County Highways detailed the discussions that were entered into following the withdrawal of the three contractors with the decision to invite the remaining six contractors to tender being well documented.
- 5.3 Tenderers were issued with a tender documentation pack and detailed the quality criteria that would be 'taken into account' in assessing whether a tender is the most economically advantageous. These were not listed in any particular order and there was no indication of the percentage to be applied to the evaluation. There was also no indication of the quality price ratio that was to be applied to the tender submission. Tenderers were informed that the financial element would only be evaluated if the quality was satisfactory.

For many years, it has been widely accepted as best practice to detail the quality/price ratio and weightings in tender documents. In fact, from January

of next year, it will be a legal requirement of EC procurement rules. Current EU regulations require, wherever possible, for the evaluation criteria to be stated in order of importance. Legal Services informed us that "our external expert advisers strongly advised that weightings of criteria should not be published because that would discourage tenderers from making their best possible submission on all aspects of the tender."

Quality assessment

5.4 Responsibility for undertaking the quality assessment was clearly assigned to specific teams with named officers. The contract evaluation process was developed over a period of time and agreed at a meeting of the evaluation team in April 2003 prior to the issue of tenders

Quality marks were broken down as follows:

•	Site reference visits	25%
•	Contract feedback meetings	5%
•	Written quality submission	35%
•	Presentation, interview and experience	35%

5.5 We are concerned that marks from the site reference visits, which were made as part of pre-qualification, were included in the overall quality mark. We understand that health and safety was again reviewed on a pass/fail basis in light of updated information. Under EC regulations a contractor cannot be failed at tender stage on something they have already passed at prequalification. PTES advise us that the site reference visit marks were not actually used at PQQ stage. In relation to health and safety, Contractor's health and safety was not reassessed in the "true sense". The responsible officer was only consulted, during the quality assessment period, when health and safety issues arose within contractors' written responses.

PTES assert that there was a clear distinction between pre-qualification and tender and that marks were not carried forward. However, it is clear that the original intention was that pre-qualification would include the reality checks and interviews. PTES decided that these would only became part of the tender process due to contractors withdrawing in mid March 2003, which ruled out the necessity of a further evaluation stage prior to short-listing. The six remaining contractors were all invited to tender in letters dated 1 April 2003, which advised that the interviews would no longer take place at this stage of the evaluation process.

5.6 We confirmed that the evaluation process undertaken followed the process laid down in Version 7 of the contract evaluation process. Our examination of the documentation held by County Highways demonstrated that the evaluation process was clearly documented with standard scoring sheets being developed which identified who had undertaken the evaluation. This then fed into overall spreadsheets for each area. 5.7 The consensus meetings that were held took the individual scores, which were entered into matrices on flip charts and any major variances identified, discussed and a consensus score agreed. The flip charts are held with the other files in County Highways, but they are neither signed nor dated. We consider that the approach of using consensus scores detracts from the robustness of the evaluation process that had been employed to this point. It is not clear what this adds to the process that taking the average of the individual scores does not. The process to this point demonstrated transparency and accountability; the application of a consensus considerably detracts from this transparency. In particular, it exposes the process to group dynamics and risks the influence of stronger individuals imposing their 'views' over the considered deliberations of others. As a result, it is not endorsed in the Constructing Excellence document (Operational issue number 1.8). However, both PTES and Legal Services argue that consensus scoring is more robust since it forces the evaluators to explore and test the reasons for differences and this can expose errors in the process or the criteria or the approach adopted.

Presentations

5.8 Presentations by contractors represented a significant part of the quality assessment. A full meeting of the evaluation team at the end of October 2003 brought together the assessment teams consensus scores and the topics to be addressed and questions to ask at the presentations were formulated. Five general presentation questions were passed to all tenderers to be addressed at the presentations. Specific questions on a series of topics arising from the quality assessment and further group of general questions were prepared. It is pleasing to note that, in accordance with best practice, tenderers were asked to explore issues outside of the tender itself, rather than go over their tender submission.

Financial Evaluation

- 5.9 The financial submission consisted of contract data part 2 and a priced activity schedule. The financial evaluation process is laid down in detail in the instructions on the evaluation process. Examination of the tender evaluation report, supporting documentation and associated spreadsheets confirmed that the financial evaluation was comprehensive and provided a ranking for each conforming bid. Financial evaluation comprised an analysis of conforming tenders, a comparison of rates, prices of alternative tenders and prices over seven years of the contract.
- 5.10 The quality price ratio was then applied to first year prices as follows:

Quality and Price Assessment (adjusted first year Prices)

Tenderer	Quality Score	Price Score	Total
Carillion	60.00	36.21	96.21
McAlpine	53.50	39.42	92.92

Raynesway	49.00	40.00	89.00
Nuttall	40.10	37.57	77.67
Assoc. Warco	39.80	32.85	72.65
Colas	36.50	32.00	68.50

The evaluation process showed that tenderers had dealt with mobilisation and establishment costs in different ways with the result that in some case the first year costs were artificially distorted. The Evaluation Team agreed that this had a direct impact on the award criteria and a further exercise was undertaken to assess price over the seven years of the contract. When the quality price assessment was applied to this evaluation the results were as follows:

Tenderer	Quality Score	Price Score	Total
Carillion	60.00	37.31	97.31
McAlpine	53.50	38.48	91.98
Raynesway	49.00	40.00	89.00
Nuttall	40.10	38.23	78.33
Assoc. Warco	39.80	32.84	72.64
Colas	36.50	32.20	68.70

Quality and Price Assessment (average annual Prices)

- 5.11 Following this additional analysis Carillion provided the best tender on both first year and annual prices. What is not clear and was not included in the evaluation process was on which basis the contract would have been awarded if different contractors had scored the highest on first year price and annual price. PTES told us that they undertook the exercise to see if there was a flaw in their evaluation process that had yielded an incorrect result. It was not necessary to determine what to do about it unless and until such a flaw was disclosed. In the event, the result was unaffected by the exercise. Had the exercise cast doubt on the correctness of the result, there were a variety of options available because the evaluation process is not in all circumstances immutable.
- 5.12 A comprehensive tender evaluation report was produced which provides sufficient narrative to support the evaluation process and a number of appendices that provide more detail to support the conclusions made by the evaluation team. We consider that this report is a good example and clearly represents best practice.

Recommendations

• Where a minimum quality standard is mentioned as part of the process this should be documented and adhered to.

- Where tenders are to be evaluated on quality as well as price the tender documents should detail the ratio to be applied and the weightings to be applied to each evaluation criterion.
- There should be a clear distinction between pre-qualification and tender. Marks obtained during the pre-qualification stage should not be carried forward to form part of the tender process.
- Guidance on the use of consensus scoring should be developed as it could weaken the transparency and accountability of the evaluation process if not carefully carried out.

6. Award of Contract

- 6.1 The contract was awarded to Carillion with a letter of formal acceptance being issued on the 11th February 2004 with a commencement of contract on the 5th May 2004. At this stage we would have expected to see a start up workshop attended by representatives of all those involved in the contract, e.g. client, contractor, sub-contractors, consultants, specialists and members. The purpose of this workshop is to encourage team working, identify mutual objectives, determine decision making processes to achieve objectives and agree details of the operation of the contract.
- 6.2 Two of the key outputs from this type of workshop would be the partnering charter and an action plan. The charter details the mutual objectives and is signed up and presented to all those attending. The action plan will have been agreed by those attending and will identify those issues that are to be considered further by whom and by when.
- 6.3 A major benefit from running a start up workshop is that it provides an opportunity to fully explore the partnering approach to all those that will be involved in the operation of the contract who may not have been directly involved in the award of the contract. It is the beginning of the cultural change that is necessary to ensure the success of this type of arrangement, allowing all parties to express their hopes and expectations and voice concerns. It allows all parties to see where the other parties are 'coming from' and should be the first stage in breaking down the suspicions of each parties motivations given years of operating traditional forms of contract.
- 6.4 A start up workshop was not held for this contract. A series of half day workshops were held and an action plan was produced at the end of July 2004. The main themes from these workshops were the need for greater understanding of the contract, the need for openness and trust and working towards an effective team. There were obviously some groups that felt aggrieved by the process and were sceptical about the contract. These issues could have been addressed in March 2004 if a start up workshop had been held.

6.5 <u>Recommendation</u>

• For future partnering contracts a start up workshop represented by all those involved in the operation of the contract is held, a charter agreed and an action plan for taking the contract forward is produced.

Detailed findings relating to the operation of the contract.

1. Management of the Contract

- 1.1 PTES are experiencing difficulties in operating the contract because appropriate systems for administering this type of contract were not determined at the outset. Despite training at the start as well as more recently, some staff do not understand the contract, or the extent to which the contract should be administered differently to a traditional contract. The roles and responsibilities of the senior managers are not clearly understood. The Core Group, which includes staff from both PTES and Carillion, has not been set up as defined in the contract, as there was no finance officer until recently representing WCC interests on the Core Group. As a result an incomplete culture of procedures and controls has developed, so that effective administration is not being carried out.
- 1.2 There are problems in communication both between different staff in PTES involved in the operation of the contract and between the PTES staff and the Carillion staff. As a result there is no clear strategic view or detailed policies and procedures on how to operate the contract. PTES staff had become demoralised as they were unclear on the procedures to follow. Some unclear or contradictory requests for changes had been requested by WCC staff from Carillion, increasing costs.

2. Target Cost

- 2.1 It was not clear how the current target for the various activities had been drawn up. There was no clear audit trail between the target specified in the contract and the May 2004, August 2004 and January 2005 versions. In particular no revisions had been made before January 2005 to reflect already agreed changes, such as the reduction in the surface dressing programme and the removal of the micro-asphalt activity. This meant that the target is not fully understood by all parties and as a result:
 - The target has not been reduced quickly enough to match the reduction in programmes;
 - Effective monitoring of the target is therefore difficult;
 - Managers at all levels do not understand the implications of rising costs;
 - Work may have had to be curtailed because of rising costs;
 - There is no certainty that the correct work will be curtailed.

We understand that PTES are now reducing the activity targets to match the reduced programmes.

PTES advise that the process for agreeing 2004/05 targets was to use tender prices and amend for any changes in volume or specification, as agreed

between client and contractor. However, they accept that the audit trail for recording changes to targets needs improving, in order that all parties can understand how targets have been arrived at, effectively monitor expenditure against them, and manage workload according to budgets available.

PTES also state that the contract imposes a duty on both parties to provide "early warning" of events that could increase targets. The Core Group needs to monitor whether this is being adhered to, in order to minimise unexpected claims for increased targets, which can adversely affect proper budget management.

2.2 There is no target for individual cost centres and Carillion have not produced budgetary forecasts for the activities. This has meant that budget monitoring cannot be effectively carried out, as detailed forecasting of total costs has not been possible. This has been particularly difficult for activities with multiple cost centres, such as ART, patching and road lighting.

PTES advise us that Carillion did not provide forecasts of outturn until very near the end of the first year of the contract. This made it difficult for PTES to conduct proper budget monitoring. For 2005/06 a new KPI has been introduced which requires Carillion to produce forecast outturn figures according to an agreed timetable. Failure to achieve this KPI will result in financial penalties for Carillion.

- 2.3 Carillion charge a fee of 5% of the target to cover their overheads and profit margin. Carillion is paid this fee on a cumulative monthly basis as part of the monthly valuation claims. We found that this had initially been incorrectly calculated by PTES, but PTES were able to correct this in January 2005. However, if the target is not sufficiently reduced to reflect the reduced programme actually carried out, the fee may be still too high.
- 2.4 PTES are currently working on finalising the total target for 2004/05. Activity schedules are being revised to reflect changes in the actual programmes carried out, which are therefore reflected in revisions to the activity prices. In addition Carillion are claiming for compensation events in relation to most of the activities carried out. Under the terms of the contract, revisions that lead to a reduction in the total target cost would reduce the amount paid by WCC as the increased overspend amounts (in excess of the target) are shared with the contractor. Conversely revisions that lead to an increase in the total target cost would increase the amount paid by WCC as the increased amount in the target is paid in full by WCC, whilst there would be a reduction in the overspend costs which are shared with the contractor.
- 2.5 Carillion have made claims for compensation events which could increase the target and therefore reduce the overspend costs. PTES are currently investigating the claims. The latest financial position for 2004/05 is stated in the Envelope of Liability Schedule (dated 13/07/2005) and is summarised as shown overleaf:

	Range		
	Minimum	Maximum	
Actual costs *	£14.5m	£15.3m	
Target costs	£13.1m	£14.2m	
(Pain) / Gain amount	(£ 0.3m)	(£ 0.1m)	
* Unallocated costs	£0.4m	£0.5m	
(included in actual costs)			

2.6 PTES had assumed that the total actual costs of the contract for 2004/05 would be the same as, or less than, the target (including the 5% fee) and so had not included any contingency in the total budget to cover for any compensation events or 'pain' on the contract. PTES had also assumed that the 'employers risk' elements were included in the target budget and had not set up any separate budget for them, even though these elements are specifically excluded from the contract. We are concerned that no contingency had been set up or a budget for the 'employers risk' elements.

PTES agreed that it would be prudent to create a contingency budget to allow for contingency and employer's risk. This will be addressed by the Project Manager with support from PTES Financial Services.

2.7 A budget for 2005/06 has been agreed and work is currently underway to develop targets. As targets have to be agreed by negotiation with Carillion, it is important that this should be done robustly.

2.8 <u>Recommendations</u>

- The 2005/06 target prices should be negotiated robustly.
- Effective budget monitoring arrangements should be introduced.

3. Open Book Arrangements

- 3.1 Open book accounting is a key feature of partnering contracts. Under the terms of the contract Carillion keeps:
 - Accounts of payments of actual cost;
 - Records which show that the payments have been made;
 - Records of communications and calculations relating to assessment of compensation events for Subcontractors; and
 - Other accounts and records as stated in the Works Information.

WCC are allowed to inspect the accounts and records that Carillion are required to keep. Carillion has developed a system called SCRAPS, which is used for all contracts. The Council have a web based access facility (WORMS) to the system to assist in verifying the amounts stated on the monthly invoices/valuation. However at the time of the audit the arrangements for open book accounting were very much in a state of development with much suspicion on the Council's side and a general lack of communication.

- 3.2 PTES had not devised a suitable method for the effective use of open book accounting, and the high-level effective monitoring of costs. As a result:
 - There is no agreed strategy;
 - There is no minimum standard of required information;
 - No effective monitoring of costs has occurred;
 - The information available is not satisfactory to confirm the financial position;
 - Incorrect claims may be paid.
- 3.3 SCRAPS is used to record the costs involved in **all** work undertaken for WCC. SCRAPS is not an accounting system consequently it has a number of weaknesses. In particular, it cannot provide an audit trail and therefore costs cannot be traced back to original records. Also costs should be able to be reconciled across SCRAPS, but this has not been possible.
- 3.4 We could not confirm the integrity of the SCRAPS system. We are concerned that costs may be incorrectly stated and the system may be double counting, leading to increased costs being paid. We found the following problems:
 - 'Hidden' costs have been allocated to activity cost centres without works order numbers and so cannot be monitored. Duplicate, inappropriate or 'other work' costs cannot be identified.
 - Some activity cost centres show works orders costs in excess of the total costs held on that cost centre, suggesting that the system may be double counting.
 - Some costs have been allocated to the 'unallocated' cost centres and cannot be monitored. These have no works order numbers. Duplicate, inappropriate or 'other work' costs cannot be identified.
 - All costs are included in SCRAPS, including those that under the terms of the contract are specifically to be paid by Carillion. These are not easily identified and so might not be disallowed.
 - Information is not stable, with input dates liable to alter to today's date;
 - Movement of costs between cost centres cannot be identified or traced;
 - Changes in data cannot be identified;
 - Reports cannot be reconciled.

Both Carillion and PTES need to be confident about the integrity and suitability of cost recording systems and it may be necessary to consider the addition of an independent cost consultant to the team, or whether it would be sufficient to rely on a suitable assurance statement from Carillion's external auditors regarding SCRAPS.

- 3.5 As a result of information provided by Audit, Carillion have recently identified that a possible £300,000 of labour costs may have been double counted. PTES have also found that some of the costs allocated to the 'unallocated' cost centre relate to 'other work' undertaken for PTES and not to this contract.
- 3.6 PTES staff do not have access to SCRAPS and instead use an internet-based system (WORMS), which produces some reports from SCRAPS. One member of PTES Finance has access directly to SCRAPS, but does not normally use it. Only a small part of the information held on SCRAPS was available to be viewed through WORMS and some information (e.g. timesheets) was only available on SCRAPS. For this reason, we consider that it is fundamental that one or more senior staff involved in agreeing claims, have direct regular access to SCRAPS.
- 3.7 PTES staff do not have confidence in WORMS because of a number of problems:
 - The WORMS generated reports do not show full and complete information and the information is not sufficiently detailed for PTES staff to confirm costings;
 - The main WORMS report used by PTES cannot be matched to the cost centre reports used by Carillion;
 - As the input date of some of the information in SCRAPS is not fixed, difficulties are caused in identifying which costs have been input to SCRAPS during which particular valuation periods;
 - IT problems (including use of passwords, access problems and training issues) have meant that PTES have often not been able to use WORMS;
 - PTES staff have agreed costs, even though they believe they might be incorrect, because of the limitations of the IT system.
- 3.8 The current PTES 'audit' check carried out on the monthly valuation claim from Carillion is not effective and costs may be incorrectly agreed because:
 - The reports generated on WORMS give false assurance of works order costs;
 - Little or no checking of costs has been carried out for some activities;
 - Prime documents for labour (including sub-contractors), plant and materials costs have not been examined and records have not been monitored;
 - PTES are unable to check for double entry of invoices or time sheets;
 - PTES are unable to check for double entry of sub-contractor invoices since sub-contractors costs are apportioned between works orders and cost centres prior to input onto SCRAPS;
 - Labour and plant standard rates have been set up arbitrarily and cannot be matched to actual labour and plant costs;
 - The procedures for monitoring material costs have not been agreed, particularly for large scale orders, so material costs may be over-stated;
 - No works order costs have yet been finalised;

- 'Hidden' and 'Unallocated' costs cannot be identified;
- The procedures for allocation of costs for non-productive plant and labour has not been agreed so idle time cannot be identified, which makes monitoring of works orders more difficult;
- Only obvious discrepancies in plant, materials and labour have been found, which may be explained as mis-codings;
- 'Other work' costs could and have been incorrectly charged to the HMC contract.
- 3.9 PTES staff had not had sufficiently clear procedures to follow when they carried out their 'audit checks' on the works orders costs. The County Treasurer's Project Team had produced detailed guidance prior to the start of the contract on the checking, certification and audit of payments and this was incorporated in the Contract Management Manual, which was issued to all staff. However this had assumed, for instance, that staff would have access to the SCRAPS system itself and that the works order costs would be finalised. As this had not happened, staff had not been able to apply the guidance.

As a result of the checks, some PTES staff involved have queried some costs, whilst other staff, for similar reasons, have disallowed the costs from the monthly valuation claims. However, Carillion have not resolved either the queried or the disallowed costs and so many PTES staff have become disillusioned with the process.

PTES accept that, for a variety of reasons, including the problems described above with the provision of financial management information, the guidance has not been consistently implemented. This will need to be reviewed and properly communicated and implemented as a result of the work now being carried out.

3.10 In summary, there was little evidence of a partnering approach being adopted to deal with issues or a move away from the traditional approach to the contractor. There is a distinct lack of understanding of partnering, how the NEC contract works and roles and responsibilities within the new arrangements. These issues could have been averted had a start up workshop been held.

3.11 PTES advise that:

"Access to and training on the SCRAPS system by the parties involved was inadequate at the start of the contract and resulted in a lack of confidence in the quality of financial management information. Managers, and latterly this audit, have also identified a number of problems with the SCRAPS system. As a result of these problems, open book accounting processes have not been conducted with the rigour required to ensure proper financial management of the contract.

Commitments by Carillion to resolve these problems were not met in the first year of the contract. A joint Project Board has now been set up to ensure that

the issue is addressed as a matter of urgency. Staff at Director level in both Carillion and PTES have been involved in this process. The Board will approve terms of reference, key objectives and outcomes, and a detailed action plan outlining responsibilities and deadlines is being produced. It will then commission tasks as appropriate to tackle specific problem areas, including the issues raised in this internal audit report.

Following on from this, the guidance produced previously will need to be reviewed to ensure it continues to be relevant and robust.

Specifically, the Project Board will need to address:

- Reconciliation of SCRAPS to monthly invoices
- Processes for reconciling invoices through SCRAPS to Carillion's ledger and prime documents
- Potential for double-counting and hidden costs
- Unallocated and misallocated costs
- Stability of data
- Access to information and training (including a review of the use of WORMS)
- Allocation of overheads."

3.12 <u>Recommendations</u>

- Finance meetings are held in the spirit of partnering with both client and contractor present.
- That roles and responsibilities of PTES are clearly defined and that effort is put into developing a sound working relationship between the Council and Carillion.
- A suitable method for the effective use of open-book accounting and the high-level effective monitoring of costs should be devised.
- Independent assurance should be requested of the integrity of SCRAPS.
- PTES should ensure that there is no double counting in SCRAPS.

4. Performance Monitoring

4.1 A number of key performance indicators were developed by WCC during the procurement process and there is comprehensive coverage in the Contract Management Manual. It is important to note that KPIs do not have any bearing on target price, they are there to indicate whether the key success factors of the contract have been achieved. In particular, robust monitoring of KPIs will ensure that continuous improvement is achieved. However, formal

performance monitoring has only recently started although specified in the contract to commence three months after the starting date.

- 4.2 We understand that PTES believe the overall standard of work is reasonable and similar to previous years. This was expected as the same staff are mostly carrying out the work. Some problems with particular machinery or individual workers have had to be addressed. We were also told that delays in patching, ART and street lighting had led to increased public complaints.
- 4.3 Carillion earn a 'bonus' for achieving the KPIs. This 'bonus' is payable at year end. However, if targets are not achieved then WCC can claim a £100,000 'negative bonus'. It is therefore essential that monitoring is robust.
- 4.4 PTES advised us that it is true that the introduction of key performance indicators was delayed but this was a conscious decision. It was decided that the training of operational staff in the use of the works ordering and financial systems, certification and audit of payments, was the priority, before introducing performance measurement processes. Performance measures were introduced, as soon as practicable, to monitor quality aspects of service delivery for all activities. However, in some areas, namely ART's and Patching, the information feedback has been inconsistent. Following experience gained from year 1, key performance indicators have been revised for 2005-6, to better reflect aspects of service delivery. As part of the work to resolve problems in financial management of the contract, three new KPIs are being introduced:
 - Percentage of deadlines met covers submission of invoice, and provision of forecast outturn and forecast pain/gain (target 95%)
 - Unallocated, misallocated and recurring disallowed costs to be resolved before next but one assessment (target 90%)
 - A KPI to reflect achievement of the outputs of the new Project Board (this will need to be determined once terms of reference, objectives and outputs have been agreed).
- 4.5 We consider that KPIs are essential to the process of monitoring the progress of the contract and therefore we do not consider that PTES should have decided to delay their introduction. Use of KPIs would have highlighted problems at an earlier stage, which will have had a cost implication. In addition the failure to apply the KPIs has meant that the 'negative bonus' as referred to in paragraph 4.3 could not be claimed by PTES from Carillion for 2004/05.

4.6 <u>Recommendation</u>

• A robust process should be developed for setting and monitoring KPIs as the basis for continuous improvement.

5. Labour costs

- 5.1 Based upon our sample checks, a large proportion of the work force (87 out of 137) had claimed for productive time in excess of 48 hours a week. Unproductive time such as for training, mobilisation, sickness and holiday is recorded separately and could increase this proportion.
- 5.2 Workers carrying out a main job for 8 or more hours a day and then adding on extra time on jobs such as ART, patching or street lighting mostly caused the excessive labour hours. Some extra hours had not been assigned to a particular works order but were costed to the 'Unallocated' cost centre. As the checking process is done by activity, this excessive time had not been apparent to PTES staff.
- 5.3 From a sample of timesheets recorded on SCRAPS, we found working weeks of up to 95 hours and workers working every day for long periods (including one of 34 days). This has repercussions for costs, quality and productivity as well as for any moral and legal responsibilities of the Council. We were not able to ascertain whether:
 - Carillion were requiring their workers to exceed the Working Time Regulations; or
 - Workers were taking advantage of Carillion's understaffing to do excessive time at overtime rates; or whether
 - Any of the claims were fraudulent.
- 5.4 The method for calculating the hourly rate for direct labour costs had not been finalised nor the treatment of annual, sick and other idle time.
- 5.5 We also found that invoices issued by sub-contractors are apportioned between works orders and cost centres prior to input onto SCRAPS. These costs are not split into the labour, plant and materials cost elements. We found that sub-contractor costs often significantly exceeded the works order target. PTES staff found that they were not able to satisfactorily check these areas.

5.6 <u>Recommendations</u>

- Excessive working time and the treatment of idle time should be resolved with Carillion.
- The effective monitoring of sub-contractor costs should be resolved with Carillion.

6 Material, plant and other costs

6.1 A substantial proportion of costs disallowed by PTES as a result of their 'audit' checks related to incorrect materials charged to particular work orders. We found that the amounts claimed for material costs could not be easily

substantiated on the SCRAPS system, as invoices cannot be identified. Therefore duplicate, inappropriate or 'other work' costs cannot be identified.

- 6.2 The method for calculating the hourly rate for plant costs has not been finalised. Also the actual hours charged for plant could not always be matched to the hours claimed on the work carried out by particular workers. We found that the procedures for allocation of idle time for plant have not been satisfactorily decided. As a result duplicate, inappropriate or 'other work' costs cannot be identified.
- 6.3 Carillion advised PTES on 21 January 2005 that the current costs included some overstated costs. This was for £289,561 for staff salaries, £50,000 for staff expenses plus a further unspecified £45,000 included in the 'Unallocated' cost centre. These have not yet been substantiated and it is not clear whether these amounts have been removed from the monthly application for payment from Carillion.
- 6.4 In March 2005, PTES were working on assigning costs that had been placed in the "Unallocated costs" cost centre. These at that point totalled £702,674.
- 6.5 <u>Recommendations</u>
 - The effective monitoring of material and plant costs and the treatment of idle plant time should be ensured.
 - Overstated and unallocated costs should be resolved with Carillion.