

INTERNAL AUDIT REPORT



Highways Contract Management 2019/20

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Highways Contract Management 2019/20

Executive Summary

1. Introduction & overall opinion

The current Highways maintenance contract was awarded to Tarmac in December 2013 for an initial period of five years, with an option to extend to a maximum of ten years. An audit of the operation and management of the contract in 2016/17 resulted in a limited assurance opinion and 15 recommendations for improvement. All except one of the recommendations in the original report have been noted as implemented. Management has requested this review to revisit the key issues arising from that report and provide assurance that the required improvements have been fully embedded and sustained. It should be noted that there have been a number of staff changes in the Places Directorate since the original audit was conducted. In particular, both the Service Director and Senior Highways Manager (SHM) at the time of the 2016/17 audit are no longer in post. The highways team is currently led by an Interim Senior Highways Manager (ISHM) who has only been in post since June 2019 and there have been a number of changes at Deputy Director level. The findings of this report should be considered within this context.

Based on this year's review a number of improvements have been delivered. For example, implementation of the new Confirm system has significantly improved the audit trail enabling the status and approval of works orders to be more effectively managed and tracked. In addition, consolidation of the contractor's fee and annualisation of the price indexation process has delivered administrative efficiencies. Nevertheless, a significant proportion of the 2016/17 recommendations have not been fully implemented or embedded into routine management practices. Consequently, there remains a risk that cost management may not be fully effective and that contractor performance might not be meeting the Council's expectations consistently. Action is required to ensure that the necessary improvements are fully implemented and arrangements put in place to ensure that staff understand the importance of delivering and sustaining the agreed controls for the remainder of the contract term.

The audit was carried out in accordance with the agreed Audit Planning Record (APR), which outlined the scope, terms and limitations to the audit. The timing of the audit was affected by a lack of timely response to requests for information in some cases.

The auditor's assurance opinion is summarised in the table below:

| Internal Audit Assurance Opinion | | | | | |
|--|---------------------|-------------------|-----------------|-----------|----------|
| Control environment | Limited Assurance | | ● | | |
| Compliance | Limited Assurance | | ● | | |
| Organisational impact | Moderate | | ● | | |
| Risk | Control environment | Compliance | Recommendations | | |
| | | | H | M | L |
| Risk 1 - Failure to implement, embed and sustain improvements arising from the 2016/17 audit report in respect of contract cost management. | Limited Assurance | Limited Assurance | 3 | 11 | 0 |
| Risk 2 - Failure to implement, embed and sustain improvements arising from the 2016/17 audit report in respect of contract quality and performance management. | Limited Assurance | Limited Assurance | 0 | 2 | 0 |
| Total Number of Recommendations | | | 3 | 13 | 0 |

2. Summary of findings

Risk 1 - Failure to implement, embed and sustain improvements arising from the 2016/17 audit report in respect of contract cost management.

Pricing options

The core contract is in two parts. Option A covers maintenance works up to a value of £30k and jobs are priced and paid based on a tendered schedule of rates. Option C covers larger scale schemes that are paid based on the contractor's actual costs with a 'pain/gain' sharing arrangement to encourage efficiencies and support value for money. All jobs are subject to an agreed percentage 'fee' for the contractor's overheads and profit.

The 2016/17 audit found that there was no clear basis for determining whether works should be ordered under option A or option C, other than a general expectation that option C would normally be used for larger projects. In addition, there was no evidenced assessment of which option would represent best value for money (VFM) for any particular project or works. It was therefore recommended that all major projects should be formally assessed to determine which commissioning method would achieve best VFM. As a result, officers proposed that any works over £30k would be reviewed by the SHM to assess if target costing (option C) is required and record the outcome on a delegated decision record. Internal Audit was informed that this recommendation was implemented in August 2017.

Based on review of documentation and discussion with officers, it is apparent that a record of pricing decisions was maintained and delegated decision forms completed until May 2018. No delegated decisions records could be located after this date and officers stated that this may be due to staff changes and new officers not being aware of this requirement. Internal Audit review of all works orders issued since November 2018 identified 23 orders over £30k, 15 of which (65%) have been priced using option A and eight using option C. The basis of the decision has not been formally recorded for any of these orders. Consequently, it is not possible to demonstrate whether the most cost effective pricing method had been applied in these cases (**see recommendation 1**).

Option A pricing

The 2016/17 audit included a review to ensure that option A works had been priced using the correct tendered rates. No significant concerns were reported but testing was repeated this year to ensure controls continue to operate effectively. Since the original audit the Council has implemented a new highways maintenance system called Confirm. All schedule of rates items and prices have been loaded into the new system meaning that works orders are automatically priced based on the items and quantities selected.

Prior to implementation of the Confirm system, two separate fee rates for profit and overheads were applied depending on whether the works were completed directly by the contractor or by a sub-contractor. Separate fee rates could not be supported in the new system so a single combined rate was calculated and applied to all prices based on historical data. Officers stated that calculation of the combined fee rate was checked and a sample of individual items tested to ensure they had been correctly uploaded to the new Confirm system. No evidence of these checks was recorded or retained although Internal Audit review of the combined fee calculations confirmed that the overall approach and basis of the calculations was reasonable.

Testing of a sample of 20 option A works orders confirmed that the correct price had been applied in most cases, although there were six cases (30%) where the price was either incorrect or not properly evidenced. Four of these related to items described as "cost plus" or "lump sum" with a total value of just over £5k. Officers stated that these usually relate to works that are not covered by an existing item on the schedule of rates. However, the basis of the agreed price had not been recorded or evidenced within the system. Consequently, it is not possible to

demonstrate that the Council received value for money and complied with any necessary competition requirements in respect of these cases (**see recommendation 2**).

Option A variations

The 2016/17 audit identified five out of eight cases (63%) where the final amount paid on option A orders was different to the original order but there was no evidence of a formally approved variation. Consequently, a recommendation was made that all variations on individual works orders above a pre-agreed limit should require prior approval. Officers agreed the recommendation which was implemented in November 2017 on the basis that variation approvals were being recorded in the notes section of previous system (RealTime).

Based on discussion with the ISHM and Highways Operations Manager (HOM), it was confirmed that a 5% threshold is applied and any variations above this level are approved in advance and recorded in the Confirm system with a full audit trail showing by whom and when each variation was approved. It was stated that it remains possible that some variations are approved retrospectively, particularly if the works are urgent, but this should be relatively rare.

Based on testing of a sample of 20 option A orders, ten cases in the sample had a variation over the 5% threshold but there was no evidence of prior approval in seven (70%) of these cases. The majority of these were shown as automatic variations applied at or after the point of payment approval. Automatic variations are created when the amount of the payment authorised is different to the original value. Consequently, the test results indicate that the majority of variations above the agreed tolerance level are still not being approved in advance. This increases the risk that contractual costs are not effectively controlled and potential unexpected budget pressures (**see recommendation 3**).

Option C pricing

Option C jobs are initially priced based on an estimate of the contractor's actual costs to complete the works, plus fees for overheads and profit. The estimate is prepared based on the nature of the works, expected quantities and latest unit costs. This information is used to establish a target price for the job which is signed off as approved by the SHM prior to commencement of the works.

On completion of the works the final account is prepared based on the contractor's actual costs. If the actual final cost of the works differs from the agreed target price (subject to any approved variations), the Council and contractor share the pain/gain on a sliding scale. Any variances of up to 9% are shared equally but any variances greater than this are shared in favour of the Council. Consequently, it is important to ensure that the initial target price is as accurate as possible and that the Council has controls in place to guard against deliberate over-inflation of costs.

Initial responses to audit enquiries indicated a potential lack of understanding of the option C pricing methodology. For example, officers stated that target costs are prepared using the option A price list and were not aware that there was a separate option C unit cost/price list. There were also references to processes and quantities being fixed and to the target price only being finalised on completion of the project (**see recommendations 4 and 5**).

Testing of a small sample of option C jobs found that there was no evidence of SHM review and sign-off of the initial target price. Officers stated that evidence is recorded in a single project file which, for convenience during a period of co-location, was retained by the contractor. Failure to keep a local record of the target price review and approval process means there is a lack of audit trail and therefore no internal evidence of the operation of this control (**see recommendation 6**).

Management of price changes

The 2016/17 audit found that there was a lack of audit trail for approval of changes to the tendered option A prices or increases in local overhead costs. A recommendation was therefore made to improve the process for documentation, review and approval of any proposed price and overhead changes, in accordance with contractual

conditions. In particular, all should include an explanation of the reason for the change, an estimate of the full year financial effect and should be subject to formal review, checking and approval at an appropriate level. Officers agreed that any future price changes would be formally considered at monthly finance meetings and approval would be properly recorded using a delegated decision form. For overheads, a proposal was being developed to apply a target costing approach in future.

Based on discussion with officers and review of contract documentation, there have been minimal option A price changes since the last audit. Those changes have been subject to formal review and approval in accordance with the terms of the contract. However, it was noted that a mixed approach appears to have been adopted to the pricing of winter maintenance services. The original contract classified winter maintenance as option A works, meaning any increases should be calculated using the relevant price adjustment indices. This approach has been correctly applied to the variable element of the service (i.e. gritting operations). However, the contract also includes a fixed element (vehicles and equipment, training, communications and standby) which appears to have been subject to annual review and negotiation outside of the contractual indexation process. Officers stated that there has been a change of approach whereby winter maintenance was moved from option A to option C, although the basis and timing of this decision was not clear. Furthermore, there is no evidence of application of the pain/gain calculation in respect of winter maintenance costs, as would be expected if the option C approach (target costing) had been properly applied (**see recommendation 7**).

It was also noted that a number of new option A rates had been added to the contract since the last audit. Officers stated that this was standard practice as the original contract only include rates for the most common works, which can change over time. New items may also be required as new materials become available, changes in the specification of materials or new ways of working are developed and improved over time. However, officers were unclear about how the process of adding new items has been managed and controlled to ensure value for money and ongoing compliance competition requirements. Whilst it was stated that supporting documentation was available from the contractor, it should not be necessary to rely on the contractor for this information; all new rates should be evidenced and approved within the Council's records using the correct contract documentation (**recommendation 8**).

The 2016/17 audit identified a potential overpayment in respect of local overhead costs that exceeded the tendered sum and amounts subsequently approved by the former SHM. Officers undertook further work in this area following the audit and recovered a small sum agreed with the contractor in May 2018. As a result of the issues raised at the last audit officers decided, with the agreement of the contractor, to apply target costing to local overhead costs from 2017/18. This was agreed subject to review of expenditure at monthly finance meetings and provision of evidence of actual expenditure prior to the sign off of final accounts at the end of the year. Whilst review of documentation has confirmed that management scrutiny of local overhead cost has occurred, it is noted that annual costs have increased by 58% since commencement of the contract. Officers who agreed the current target costs are no longer in post and current staff were unable to explain the reason for the increase. Given the scale of the increase, Internal Audit has emphasised the need to continue close and regular scrutiny and challenge of overhead costs for the remainder of the contract.

Adequacy of the audit trail

The 2016/17 audit found that, whilst there was a clear audit trail in respect of raising works orders, evidence of approval of completion of jobs could not be provided within the RealTime system. It was therefore recommended that evidence of approval of individual works orders should be recorded and retained either in RealTime or in a separate record to ensure there is an adequate audit trail. Based on discussion with officers and testing of a sample of works orders in Confirm, it was established that the new system retains a full audit trail with details of the officer, date and time works orders were raised and marked as completed.

Officers stated that the contractor is required to upload photographic evidence of satisfactory completion of works within Confirm before orders can be marked as completed on site. In addition, most jobs are subject to site

inspection by a member of the Council's highways team. However, testing of a sample of 20 works orders identified 11 cases (55%) where no photographs had been uploaded and no other evidence of completion of the works was available (**see recommendation 9**).

Contract inflation (indexation)

All option A jobs are subject to a monthly price adjustment factor (PAF) based on the Highways Term Maintenance Indices produced and published monthly by the Building Cost Information Service (BCIS). At the time of the 2016/17 audit the PAF was being applied to monthly invoices on a job-by-job basis. However, the PAF calculations were not being checked or verified by the Council. A recommendation was therefore made that a proportionate sample of price adjustment calculations should be checked and verified to published BCIS figures.

On implementation of the new Confirm system in November 2018 it was agreed to simplify the PAF process. This was done by calculating an annual uplift based on the average movement in the relevant indices across each service area. The increase was applied to uplift individual option A prices which were then directly loaded into Confirm. This means that checking can be done as a one-off annual exercise rather than monthly and has significantly reduced the administrative effort required. The annual uplift calculations for 2018/19 and 2019/20 were provided by the contractor and checked and approved by the Council. However, the checking process was not recorded or evidenced (**see recommendation 10**).

Internal Audit review of the PAF calculations for 2019/20 found that the methodology was highly technical and complex. However, the basis of the calculations was found to be logical and reasonable and test-checking did not identify any errors. It was also noted that the PAF adjustment had been applied to certain items (Paco Patch) that had previously been subject to a price increase with the express condition that they were to be paid on a "cost plus" basis outside of the PAF arrangement. By applying the PAF to these items the price paid is approximately 5% higher than the agreed rates. Consequently, it is likely that the contractor has been overpaid in respect of any works order containing Paco Patch items raised after application of the revised PAF approach. It is not possible to quantify the potential overpayment at this stage (**see recommendation 11**).

Invoice reconciliations

The 2016/17 audit found that invoices were not checked or reconciled back to approved works orders in the RealTime system. A recommendation was therefore made that invoices should be checked to ensure that the total reconciles to a list of approved works orders prior to being passed for payment. Now that the Council has moved to the Confirm system, all invoices are supported by a detailed schedule of completed works orders. Furthermore, officers stated that once an order has been marked as paid within Confirm it cannot be re-opened. This means it is not possible for the contractor to submit duplicate payment requests for the same works order. Testing of a sample of invoices found that all agreed to the relevant list of completed jobs.

Option C final accounts

On completion of option C projects the contractor prepares a final account setting out the actual costs (plus fee) for completion of the works. This includes a comparison to the approved target price and calculation of the pain/gain element of the job. At this stage only the actual cost is paid to the contractor with the pain/gain element pooled for consideration at the year-end based on achievement of annual performance targets. The 2016/17 audit found that option C final accounts were reviewed and verified to the contractors actual cost records by officers prior to being approved for payment by the Senior Highways Manager. However, the review and verification process was not formally evidenced or signed-off. A recommendation was therefore made that the verification process should be recorded and the final accounts formally certified as accurate.

Based on discussion with officers for this year's audit, it was stated that the process for approval of option C final accounts focuses on measuring quantities rather than verification of the contractor's actual costs. Furthermore, whilst officers confirmed that evidence of review and approval of option C final accounts is available, Internal Audit was again referred to the contractor for evidence of this process (**see recommendation 12**).

Testing of a sample of two option C jobs found that the final account had not yet been finalised for one but the other (Lyddington surfacing works) had been overpaid. The reason for the overpayment is not clear, although it appears that the pain/gain element may have been paid twice, both on submission of the final account and as part of the year-end payment of the annual pain/gain pool (**see recommendation 13**).

Option C inter-company prices

2016/17 testing of an option C job confirmed that costs were consistent with the contractor's financial records, although a significant proportion of costs related to inter-company transfers (e.g. internally produced materials and plant recharges). Limited evidence was available to provide assurance that these transfers represent value for money. It was therefore recommended and agreed by management that checking and approval of option C jobs should include obtaining periodic assurance and evidence that inter-company prices reflect genuine market rates.

For this year's audit, based on review of contract documentation, it was noted that option C unit costs are subject to annual review and approval by the Senior Highways Manager, albeit not always using standard contract documentation. It was also noted that the proposed unit cost prices for 2019/20 had not been formally approved at the time of audit. Furthermore, officers stated that they are not aware of any checks to market rates for inter-company transfer prices (**see recommendation 14**).

Based on the above findings, the assurance rating for the design and compliance with controls to mitigate this risk is **Limited Assurance**, as it is evident that a number of the improvements agreed from the last audit have not been fully embedded or sustained.

Risk 2 – Failure to implement, embed and sustain improvements arising from the 2016/17 audit report in respect of contract quality and performance management.

Inspections

The 2016/17 audit found that works orders are signed off as complete based on a combination of photographic evidence provided by the contractor and selective inspections/site visits by highways staff. However, the basis for selecting jobs for inspection had not been formalised and site visits and outcomes were not being recorded. Consequently, it was agreed with management that a proportionate methodology should be established for selecting projects and works for inspection and that all inspections should be properly recorded.

At the time of this audit the previous recommendation remains outstanding and has not therefore been repeated. Officers confirmed that inspections continue to be carried out but that no system of recording or evidencing is currently in place.

Performance monitoring and reporting

The contract includes 12 key performance indicators (KPIs) each with a detailed definition, target and basis of calculation. However, the 2016/17 audit found that plans were in place to review and refine the agreed KPIs as some were not considered by the Council or contractor to be fit for purpose. In addition, testing found that performance against targets was not clearly evidenced, there was no clear audit trail to the supporting data and errors were found in a sample of the KPIs tested. A recommendation was made to improve the format of performance reports to make achievement of targets clearer and to provide a better audit trail to the supporting data. It was also agreed that officers would undertake sample testing of the accuracy of reported performance levels.

Based on discussion with officers and review of the 2018/19 year-end performance report, it was noted that the majority of the 12 KPIs set out in the original contract continue to be collected and reported with some amendments and some additional indicators that have been agreed with the contractor. The report format provides a much clearer basis for demonstrating compliance with agreed targets and is used to inform contract

extension decisions. However, there remains no clear audit trail to the underlying data (**recommendation 15**). The new Confirm system includes a performance dashboard that provides a snapshot of performance against agreed response times, although it is not clear how this links to the performance levels within the KPI report and there are a number of other KPIs that are not included in the dashboard.

No performance information was provided in respect of 2019/20 meaning audit testing of the accuracy of KPIs was not possible. Furthermore, officers stated that there is no evidence that the agreed sample checking of KPIs by the highways team has been undertaken since the original recommendation was made (**see recommendation 16**).

Impact of performance on pain/gain entitlement

The 2016/17 audit found that, whilst the contract allows for reductions to the option C pain/gain pool on the basis of the level of achievement of annual KPI targets, this adjustment was not being applied in practice. It was therefore agreed with management that the pain/gain on individual option C final accounts would be aggregated, adjusted against KPIs (if required) and signed off for payment annually at the Network Board Meeting.

There is no evidence of consideration of the pain/gain payment by the Network Board, but officers confirmed, and provided evidence, that the 2018/19 entitlement was properly pooled and reviewed at the year-end. The full entitlement was approved for payment on the basis of achievement of 100% of KPI targets, as evidenced in the 2018/19 performance report.

Contractor liaison meetings

According to the contract, there are two management groups responsible for overall governance and performance management of the contract: the Network Board and Operational Management Team. Network Board meetings were relatively infrequent but fully recorded and minuted. Operational Team meetings were held monthly along with separate meetings focused on finance and performance. All meetings were recorded but not formally minuted and meeting notes were often brief and lacking clarity. A recommendation was made that that all contract management meetings should have formal agendas and be fully minuted in future, including any agreed action points.

Based on discussion with officers it was stated that Network Board meetings are now held quarterly and operational and finance meetings remain monthly. However, performance meetings have not been held since departure of the former SHM, the most recent Network Board meeting has not yet been minuted and the quality and clarity of other meeting records remains variable. Officers have been reminded of the importance of fully and clearly recording all contract liaison meetings to minimise the risk of misunderstandings or disagreements.

Based on the above findings, the assurance rating for the design of controls to mitigate this risk is **Limited Assurance** as it is evident that a number of the improvements agreed from the last audit have not been fully embedded or sustained.

3. Action plan

The following action plan provides a number of recommendations to address the findings identified by the audit. If accepted and implemented, these should positively improve the control environment and aid the Council in effectively managing its risks.

4. Limitations to the scope of the audit

This is an assurance piece of work and an opinion is provided on the effectiveness of arrangements for managing only the risks specified in the Audit Planning Record.

The Auditor's work does not provide any guarantee against material errors, loss or fraud. It does not provide absolute assurance that material error, loss or fraud does not exist.

ACTION PLAN

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|---|---|--|----------|-------------------------|--------------------------------------|
| 1 | The 2016/17 audit found that there was no clear basis for determining which projects should be commissioned under which pricing option. It was therefore agreed that any works over £30k will be reviewed by SHM to assess if target costing is required and recorded on a delegated decision record. This control has not been applied since May 2018. | Reinstate the control of recording the basis of selection of the most suitable pricing method for major works orders. Consider whether the threshold of £30k for recording such decisions should be reviewed. | The £30,000 threshold has been used since May 2018, however the supporting evidence for the decision making may not have been fully recorded. For future schemes the £30,000 will apply and appropriate notes logged. For schemes such as surface dressing, where a sub-contractor is used and the work is made up of a number of smaller schemes, but the total is in excess of £30,000, the supporting notes will reflect this fact. The due date for this recommendation reflects when this will be fully in place, and the fact no further schemes will be in this category until 2020/21. | Medium | Senior Highways Manager | 29 th February 2020 |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|--|---|--|----------|-------------------------|-------------------------------|
| 2 | Testing of a sample of works orders found 6/20 cases (30%) where it was not possible to agree the unit rate charged to contractual rates or other evidence of the agreed price. In 4 of these cases the item was described as a "lump sum" or "cost plus", although there was no evidence on file to demonstrate the basis of the agreed fee. In these cases it is not possible to demonstrate achievement of value for money. | Works orders that are raised using the "cost plus" or "lump sum" option should include details of the basis for determining and agreeing the price. For example, quotations, estimates or other documentation demonstrating agreement of the price and compliance with contractual and/or procurement requirements should be attached to the relevant works order in Confirm. | Agreed, while this does happen, it is clear the supporting evidence is not adequate. While it is expected that the number of occasions where cost plus or lump sum will be limited, supporting information will be provided by Tarmac and approved by the client in advance of works orders being approved. | Medium | Senior Highways Manager | 31 st January 2020 |
| 3 | Testing of a sample of works orders identified 10 cases that had a variation over the 5% allowable threshold, although there was no evidence of prior approval in 7 (70%) of these cases. The majority of these cases were shown as automatic variations applied at or after the date of payment approval. Lack of prior approval of variations weakens overall cost control and could lead to poor value for money and unexpected budget pressures. | Review the 5% tolerance level for variations to ensure that it remains practical and consider whether a monetary limit should also be applied and/or any exceptions specified. Once reviewed, variations on individual works orders outside of the pre-agreed limits and exceptions should require prior approval in all cases. Highways team members should be reminded of this requirement and the contractor should be advised that works should not proceed until approval has been obtained. The Council should consider measures to ensure compliance with this requirement, such as non-payment of the un-approved portion of the order or the introduction of additional performance indicators with suitable financial penalties for non-compliance. | It is agreed that the 5% tolerance level for variations will be reviewed by the client in conjunction with Tarmac. Once agreed, then all variations outside that level will require prior approval. Only in exceptional circumstances will a post approval, outside the tolerance level, be allowed and the justification provided be of an exceptional situation. Notes supporting the decision to post approval will be logged on Confirm. | High | Senior Highways Manager | 31st January 2020 |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|---|--|---|----------|-------------------------|---------------------------------|
| 4 | Responses to some audit enquiries indicated a potential lack of understanding of the open book aspects of the contract (option C), particularly in respect of development and approval of the initial target prices and verification of final accounts. | Officers managing option C jobs should be given training to ensure that they fully understand and can effectively manage and control open book contracts of this nature. They should also ensure a thorough knowledge of the terms and conditions of the contract. | Agreed, however the officer undertaking Option C schemes is on leave until early February. Timing of training is flexible at present, but will be complete before any Option C schemes need be target priced. | Medium | Senior Highways Manager | 31 st March 2020 |
| 5 | Officers stated that they were not aware of the existence of a separate option C price list and were using option A prices to develop the option C target prices. This increases the risk of target prices inaccuracies which could impact the final pain/gain calculation. | Option C jobs should be priced using the correct price list reflecting the latest best estimate of the contractor's actual unit costs | See Management Comments to Rec. 4. | Medium | Senior Highways Manager | 31st March 2020 |
| 6 | Testing of a sample of option C projects found that evidence of sign-off of the agreed target price had not been retained by the Council. All evidence was retained by the contractor in a single project file prepared during a period of co-location. | Evidence of the review and approval of target prices for option C jobs should be recorded and retained by the Council. The agreed target price should be formally signed-off by the Senior Highways Manager prior to commencement of the works. | Agreed, while I am aware there has been good due diligence over the sign off, the supporting information may not reflect this fully. I can confirm that all future Option C projects will be the subject of formal sign off by the Senior Highways Manager. | Medium | Senior Highways Manager | 29 th February 2020. |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|---|---|--|----------|-------------------------|-----------------------------|
| 7 | Winter maintenance is an option A service under the terms of the original contract. However, review of documentation and testing of works orders identified a mixed approach with the fixed element now priced under option C. Current staff were not party to this decision and were therefore unable to explain the basis or reason for the change of pricing approach or inconsistency with contractual terms. | Clarify the basis of pricing for winter maintenance to ensure that it complies with contractual conditions. In particular, if priced under option A then rates should be increased annually in accordance with the agreed PAF/indexation approach. If priced under option C the target costing and pain/gain process should be applied. | Since the Audit, I have been able to clarify that winter maintenance is option A as the original contract. I also can confirm for winter 2019/20 it is still option A. | Medium | Senior Highways Manager | 31 st March 2020 |

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|---------|--|---|--|----------|-------------------------|-------------------------------|
| 8 | There have been 55 new option A prices added to the contract since the 2016/17 audit. However, there is no evidence of formal review or approval of the new rates. | Any future price increases outside of the annual PAF/indexation process or addition of new rates to the option A price list should be evidenced and recorded using the formal contract documentation (contractor and/or service manager notices and instructions). This should include consideration of the overall financial impact and compliance with competition requirements in contract procedure rules, where appropriate. | Agreed, however to deliver the service effectively works to the highway may require non-standard items, which for 'one offs' will be via the lump sum/cost plus mechanism or via the approving of an additional option A price. The revised option A price will require supporting information to substantiate the price offered. It will not be possible to determine the future frequency of the new item for the residual life of the contract and thus the future total contract value for the item. It is however important to understand that the need is a service generated requirement supported by evidence the price is competitive at the time of the request. | Medium | Senior Highways Manager | 31 st January 2020 |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|---|--|---|----------|-------------------------|-------------------------------|
| 9 | Testing found no evidence of satisfactory completion of works (e.g. photographs or inspection records) in 55% of cases. Consequently, it is not possible for the Council to demonstrate that works are being completed to the required standard in the majority of cases. | <p>Where no photographic evidence of satisfactory completion of works is attached to the works order, officers should provide a note of the basis upon which the order has been confirmed as satisfactorily completed and approved for payment.</p> <p>[Note: this recommendation should be considered in conjunction with the outstanding recommendation from 2016/17 in respect of recording inspections. The outstanding recommendation being:</p> <p>‘An agreed and proportionate methodology should be established for selecting projects and works orders for inspection (e.g. a fixed percentage of weekly jobs selected based on size and risk). All client side inspections should be recorded / evidenced and attached to the relevant works order on Real Time.’]</p> | <p>Agreed, photographic evidence is required to be submitted by Tarmac on all works order submissions. In circumstances where there is no photograph, a note from Tarmac explaining the reason for the non-supply is required and the client officer has to accept the terms or if not satisfied, to reject the submission until a photograph or acceptable explanation is provided. This was agreed at the Operations Meeting on 9 January 2020.</p> | Medium | Senior Highways Manager | 31 st January 2020 |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|--|---|---|----------|-------------------------|-----------------------------|
| 10 | The PAF calculation has been annualised and incorporated into rates loaded into Confirm. The calculation and upload process was carried out by the contractor and checked by the Council. However, no evidence of these checks was recorded or retained. | Sample checking of annual indexation calculations, including verification of the indices and testing for accurate upload of the uplifted rates into Confirm, should be clearly evidenced. For example, the date and name/initials of the person carrying out the check could be recorded on the indexation spreadsheet alongside the individual rates that have been tested. The sample size should be risk based and proportionate (e.g. 5%) and/or focus on the most commonly used items. | Agreed, and since the conclusion of this Audit evidence supporting the fact that historically the calculations and verification of the indices did occur. Irrespective I can confirm that the sample calculations and verification of indices will be undertaken at the next PAF review date (March 2020) and that the Operations Manager will be included in the process to ensure there is consistency of approach for the duration of this contract, | Medium | Senior Highways Manager | 31 st March 2020 |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|---|---|--|----------|-------------------------|--------------------------------|
| 11 | PAF has been incorrectly applied to Paco Patch rates which were increased in 2017 with the express condition that the rates remain outside of the PAF arrangement and that any future increases should follow a market testing methodology. Consequently, it is likely that the contractor has been overpaid. | Review all jobs with Paco Patch raised since consolidation of the PAF adjustment (January 2019) to determine the value of any potential overpayment and seek a refund from the contractor and correction of the rates in Confirm. | Investigation is ongoing to the terms of use of the Paco Patch just to confirm whether these rates remain outside the PAF calculation. If it is found to be correct, then it has been agreed with Tarmac here will be a review of the schemes where Paco Patch was used and the PAF have been applied. These will be combined into a calculation for the over-charge and this figure will be returned by Tarmac. | High | Senior Highways Manager | 29 th February 2020 |
| 12 | Verification of option C final accounts is currently focused on the measurement of quantities without verification of the contractor's actual costs. Consequently, there is a risk that the final account may not accurately represent the actual cost of completing the works (plus fee). In addition, evidence of review and approval of final accounts was not retained by the Council for the projects sampled by Internal Audit. | Checking and verification of Option C final accounts should include examination of the contractor's actual costs as recorded in their accounting records (as per the open-book principles in the contract). Evidence of this process should be recorded and retained by the Council, including formal sign-off of the final account by the Senior Highways Manager. | Agreed, while this is presently being done, the evidence to support the verification process may not be as stringent as required. The process will be reviewed and improved for any option c schemes in 2020/21 | Medium | Senior Highways Manager | 29 th February 2020 |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|---|--|---|----------|-------------------------|--------------------------------|
| 13 | Testing identified one option C job with an inconsistency between the amount invoiced and paid to the contractor and the agreed final account. It appears that the overpayment may be related to the pain/gain entitlement being paid twice – once on completion of the works and also as part of annual payment of the 2018/19 pool. | The overpayment in respect of works order 410000020 (Lyddington carriageway surfacing) should be recovered from the contractor. All other option C jobs completed in 2018/19 should be reviewed to ensure that no other overpayments have occurred. | Noted and we are investigating with Tarmac the Lyddington scheme and if it is the case any overpayment from adding the pain gain to the invoice at works completion will be recovered from Tarmac. | High | Senior Highways Manager | 31 st January 2020 |
| 14 | The option C price list is reviewed and updated annually. The 2018/19 prices were approved by email only and the 2019/20 prices have not yet been approved. In addition, there is no evidence of checking inter-company price changes to alternative market rates, as recommended in 2016/17. | Annual review and approval of option C unit cost changes should be formally evidenced using the correct documentation (Service Manager Instructions / Notices). Evidence of challenge and review of cost increases should be clearly recorded, particularly in respect of inter-company transfer prices where evidence should include comparison with alternative providers or other indicators of market rates. | Agreed, incidentally before this Audit was confirmed, I had received the option c price list for review for 2019/20 and requested supporting information. To date the supporting information is insufficient for me to approve the revise price list. | Medium | Senior Highways Manager | 29 th February 2020 |
| 15 | KPI reports found that the format has improved and that achievement of targets is clearly presented. However, there remains no clear audit trail to the underlying data, as recommended in 2016/17. | KPI worksheets should include a clear audit trail between the recorded KPIs and the source data to provide assurance that reported performance is complete and accurate. | Agreed. Since the conclusion of this audit supporting information has been found which demonstrates that the KPIs were reviewed regularly. | Medium | Senior Highways Manager | 31 st January 2020 |

| Rec No. | ISSUE | RECOMMENDATION | Management Comments | Priority | Officer Responsible | Due date |
|---------|--|---|---------------------------------------|----------|-------------------------|--------------------------------|
| 16 | No 2019/20 performance information was available at the time of audit and could not therefore be tested for accuracy. In addition, there is no evidence of periodic sample testing by officers, as recommended in 2016/17. | Performance reports for 2019/20 should be requested and reviewed by officers on a regular basis (monthly or quarterly). A sample of KPIs should be periodically tested to supporting evidence, as previously recommended. | Agreed, see note on recommendation 15 | Medium | Senior Highways Manager | 31 st January 2020. |

GLOSSARY

The Auditor's Opinion

The Auditor's Opinion for the assignment is based on the fieldwork carried out to evaluate the design of the controls upon which management rely and to establish the extent to which controls are being complied with. The tables below explain what the opinions mean.

| Compliance Assurances | | |
|-----------------------|---|---|
| Level | Control environment assurance | Compliance assurance |
| Substantial ● | There are minimal control weaknesses that present very low risk to the control environment. | The control environment has substantially operated as intended although some minor errors have been detected. |
| Good ● | There are minor control weaknesses that present low risk to the control environment. | The control environment has largely operated as intended although some errors have been detected. |
| Satisfactory ● | There are some control weaknesses that present a medium risk to the control environment. | The control environment has mainly operated as intended although errors have been detected. |
| Limited ● | There are significant control weaknesses that present a high risk to the control environment. | The control environment has not operated as intended. Significant errors have been detected. |
| No ● | There are fundamental control weaknesses that present an unacceptable level of risk to the control environment. | The control environment has fundamentally broken down and is open to significant error or abuse. |

| Organisational Impact | | |
|-----------------------|---|--|
| Level | Definition | |
| Major ● | The weaknesses identified during the review have left the Council open to significant risk. If the risk materialises it would have a major impact upon the organisation as a whole. | |
| Moderate ● | The weaknesses identified during the review have left the Council open to medium risk. If the risk materialises it would have a moderate impact upon the organisation as a whole. | |
| Minor ● | The weaknesses identified during the review have left the Council open to low risk. This could have a minor impact on the organisation as a whole. | |

Category of Recommendations

The Auditor prioritises recommendations to give management an indication of their importance and how urgent it is that they be implemented. By implementing recommendations made managers can mitigate risks to the achievement of service objectives for the area(s) covered by the assignment.

| Priority | Impact & Timescale |
|-----------------|---|
| High ● | Action is imperative to ensure that the objectives for the area under review are met. |
| Medium ● | Requires actions to avoid exposure to significant risks in achieving objectives for the area. |
| Low ● | Action recommended to enhance control or improve operational efficiency. |