

***Isle of Wight Council***

***Internal Audit Report 2015/16***

Highways PFI

April 2016

FINAL

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## Distribution List



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The report has been prepared solely for the Isle of Wight Council, this report should not be disclosed to any third party, quoted or referred to without prior approval from internal audit.

# 1. Executive summary

<b>Report classification</b>  <b>High Risk</b>	<b>Trend</b>  We have not previously reviewed the framework in place to manage the client relationship with Island Roads	<b>Total number of findings</b>					
			<b>Critical</b>	<b>High</b>	<b>Medium</b>	<b>Low</b>	<b>Advisory</b>
		Control design	0	1	3	0	0
		Operating effectiveness	0	0	0	0	0
		<b>Total</b>	<b>0</b>	<b>1</b>	<b>3</b>	<b>0</b>	<b>0</b>

## Summary of findings:

This review was undertaken as part of the 2015/16 Internal Audit Plan, agreed by the Audit Committee. The purpose of this audit was to review the arrangements the Council has put in place to resolve outstanding issues and manage the Highways PFI Contract for the long term; this review covered the following areas:

- *Outstanding Issues:* to ensure the Council has responded appropriately to the work carried out by Atkins (a specialist engineering consultancy), regarding mechanisms which should be put in place to better manage the client relationship; specifically recommendations have been implemented or plans are in place to either implement recommendations or put equivalent mechanisms in place to address the underlying risk.
- *Contract Management:* a suitably resourced and qualified team are in place or in the process of being put in place to manage the Contract.
- *Call Off Arrangements:* an agreed schedule of fees for additional services is in place, along with documented arrangements for managing any additional services procured.

The PFI is a long term contract, larger in scale than anything attempted by the Council previously - in excess of £725 million over 25 years; with a Contract of this scale there will always be 'teething problems', for example where arrangements envisaged by the Contract are found not to work well in practice, or elements open to different interpretations, which need to be clarified and agreed between both parties. This process has taken longer than desirable and is still ongoing at the time of our review; the underlying reasons, from the Council perspective, for this delay are summarised below:

- A change in political administration immediately subsequent to the Contract being signed.
- A loss of knowledge regarding the Contract from the procurement phase, due to a number of key staff leaving the Council.
- Informal approach to record keeping, for meetings held between the Council and Island Roads.
- Reduced capacity, specifically technical expertise, with all historic members of the Highways Department transferring to Island Roads and, due to wider cost pressures, sufficient staffing not being put in place by the Council to appropriately manage the client relationship.

The overarching finding of our review is that current arrangements are a significant improvement from those which have been in place for the last three years. In early 2015 the Council engaged Atkins, a specialist engineering consultancy, to provide short term technical expertise, due to a lack of specialist capacity at the Council. Atkins also reviewed the Contract and current arrangements, identifying potential enhancements for consideration, to put the Contract on a firm basis for the remainder of its 25 year term. Atkins' recommendations are in the process of being responded to and we note that the most pressing requirement, to put an appropriately sized and skilled contract management team in place, has been substantively addressed, with two qualified and experienced highways engineers being recruited in Autumn 2015 and a draft team structure, including staff with legal and financial expertise, pending finalisation.

However in the short term there remain significant PFI related risks for the Council, specifically:

- The ongoing process of resolving issues, for example the adjudication (external solicitors was asked to give an opinion on points where the Council and Island Roads have different interpretations on elements of the Contract) regarding elements of the Contract, with the risk that this will result in additional, ongoing costs for the Council.
- Reliance on Island Roads 'self-reporting' their performance, with payment reliant on meeting specific performance indicators. Without robust validation by the Council there is an increased risk that necessary performance deductions will not be made, meaning the Council will not pay the correct amount for the service it has received.

Due to these factors this report has been rated as high risk overall, with a detailed finding covering contract performance individually rated as high risk. The Council will need to decide how to resolve outstanding disagreements with Island Roads, for example regarding what constitutes the Project Network, which could take some time. Other issues are fully covered by Atkins, who made detailed recommendations as to how they could be addressed. Realistically the Council will not be able to fully progress Atkins recommendations, primarily due to the level of funding which is available. The Council is taking a pragmatic approach, focussing on ensuring that the underlying issues are addressed as robustly as possible, within its funding constraints. We have raised four detailed findings, summarised below:

- *Performance Management*: at a high level there are two elements to the performance management of the relationship with Island Roads:
  - *Core Investment*: as Island Roads improve the Project Network, work is signed off by an independent certifier, Mouchel, with payment being made by the Council accordingly. We were informed that this element is working better and note that the Council has extended the relationship with Mouchel for a further three months, with discussions ongoing regarding a further extension.
  - *Business as Usual*: the Contract sets out detailed performance standards which Island Roads has to meet, for example response time for emergency repairs. There are a number of mechanisms in place to support this, specifically access to a 'live' MIS (Management Information System), regular reporting and meetings between Island Roads and the Council.

There are a number of issues with how the second element above is currently managed, for example the remit, number, management and attendance at meetings. However the main issue is reliance on self-reporting of performance by Island Roads, with only limited reconciliation and validation work carried out by the Council. Atkins made a number of specific recommendations regarding this, for example enhancing how information is reconciled from reports back to the MIS (while this is carried out it is a time consuming and excessively manual process; an audit tool from Mouchel is in the process of being implemented, which has the potential to streamline the process, clearly linking performance indicators to evidence in the MIS), to ensure they are consistent and sample checking a subset of work carried out by Island Roads. Sample checking is currently carried out but only on an ad hoc basis, rather than a consistent process, informed by decisions made against quantified criteria as to when work will be inspected. While it will not be possible to fully implement all of Atkins recommendations the Council must ensure that they have appropriate arrangements in place to sufficiently address the underlying issues. Due to the potential for overpayment we have raised this area as a **high risk** finding.

- *Action Plan*: a draft action plan has been produced, covering the issues identified by the core Atkins' reports, on staffing structure and performance management; this is currently with the Head of Contract Management for review. Atkins work was wide ranging, encompassing producing in excess of 40 report as well as more informal technical support for the nine months during which Atkins' staff were on site. To ensure that the Council achieves VfM from its spend with Atkins and that the underlying issues are correctly addressed, the action plan should be broadened, to cover all of Atkins' work, with ownership and due dates identified for all actions. Once finalised the action plan should be formally managed, with any issues/blockages escalated to senior management for resolution.

We note that with the cost constraints the Council is operating under, it may be appropriate for the original Atkins' recommendations to be modified, to exploit synergies offered by jointly addressing some areas alongside arrangements to manage the Waste Contract and areas such as coastal engineering. This could include legal and financial support (informally this is already in place, with two members of staff partially collocated with the core PFI Team) helping to ensure that mechanisms implemented are affordable. We have raised this area as a **medium risk** finding.

- *Staffing*: between April 2013 and December 2014 there were a number of changes in staffing on the Council side, responsible for managing the Contract and specifically the relationship with the provider, Island Roads. Ultimately by late 2014 the Council had few staff who had any knowledge of the Contract and specifically no highway engineers. As above Atkins, a specialist engineering consultancy, were engaged in early 2015, part of their remit being to make recommendations regarding the staffing levels and skillsets necessary to manage the PFI long term. At a high level, Atkins recommended a Team of approximately 18.5 FTEs, with specific skills in engineering, finance and valuation.

As above the Council are not planning to fully implement Atkins' recommendations, due to cost constraints and the Council leveraging opportunities to share staff and skillsets across Highways, Waste and other related areas – the actual team will be less than that recommended by Atkins but the Council is confident that its staffing plans will provide an effective and sustainable Team, sufficiently resourced to provide effective oversight to the PFI Contract. However PFI, at in excess of £725 million over 25 years, is the largest Contract the Council has ever let. As part of the Council's response to Atkins' work, their recommendations should be revisited, to confirm that the Team is sufficiently resourced, both in terms of numbers and skillsets. To ensure that the Team has access to specialist support if required, call off arrangements should also be put in place (as recommended by Atkins). We also noted that, apart from the two highway engineer posts, job descriptions are out of date, the majority last being revised in 2013. As part of the restructure in this area, job descriptions should be revised and updated, to ensure they are reflective of practice. We have raised this area as a **medium risk** finding.

- *Call off Services*: a defined process is set out in Schedule 17 of the PFI Contract, identifying prices and the process which should be followed to request, deliver and pay for additional services. During the first three years of the Contract additional services have totalled under £1 million, primarily stemming from local sustainable transport, all categorised as low value.

There are two issues with the way call off services are currently managed: lack of quality assurance and no significant infrastructure to date having being accrued (incorporated into the Project Network, for the purposes of ongoing maintenance) to the network, due to the additional costs which would be incurred. Both of these should be addressed by defining quantified criteria to support a consistent process. For example, dependent on the nature of the change, in some circumstances it may be cheaper in the long term to accrue infrastructure to the network, while where nonstandard, non-accrued work is carried out (i.e. where the ongoing cost of maintenance will be borne by the Council) it may be justified to quality assure the work. We have raised this area as a **medium risk** finding.

We would like to take this opportunity to thank Isle of Wight Council staff for their help and assistance with this review.

# 2. Detailed current year findings

## 1. Performance Management – control design

### Finding

At a high level a survey of the Highway Network condition was taken before Island Roads started the improvement works to the road network on the Island, scheduled for the first seven years of the Contract (referred to as the 'core investment period'). Across the seven years, milestones are defined every six months, by which the road network must have 'improved' by a specified amount. Work carried out is validated by an independent certifier, Mouchel, triggering 'uplift payments' from the Council, provided the required improvement to the network has been delivered. We were informed that the Council is satisfied that this element of the Contract is working better and has recently reappointed Mouchel for a further three months. We were provided with the latest milestone certificate from Mouchel for review. This clearly identifies the improvement works Island Roads has delivered in the last six months, although we did note that not all road improvements are physically inspected, rather this is done on a sample basis, as specified in the PFI Contract.

At a more granular level performance indicators are specified in detail in the Contract, for example:

- Timescales within which requests, such as emergency repairs, must be responded to in.
- Grass lengths to be maintained on verges.

Broadly the Council are satisfied with the performance indicators in place and specifically a MIS (Management Information System, online based) is available to Council staff, giving up to date information regarding performance. The MIS is planned to be supplemented by a reporting/audit system, Confirm, with reporting structured around specified performance indicators. A number of performance reports are also shared with the Council, for example monthly reports detailing performance against the agreed performance standards and cost deductions made by the Council where these have not been met, the last three performance reports having been provided for our review. These clearly identify performance against each 'standard' and where the Council has made payment deductions where the agreed standard has not been met.

Atkins made a number of detailed recommendations regarding how performance should be enhanced. How the Council responds to recommendations is still being considered and all are included on the draft action plan. From our review of the Atkins report on Performance Management, recommendations which are likely to be of particular value are listed below:

- Desktop review of monthly reports against the information in the MIS, to ensure they are consistent;
- Island Roads to share internal audit plans and significant findings;
- Encouraging Island Roads to gain independent accreditation against quality management standards; examples include ISO 55000 for asset management and ISO 9001 covering quality management;
- Site inspections by Council staff (sample of 1 to 2% suggested);
- A formal risk based audit programme, covering different elements of the Contract on a rotational basis;
- A balanced scorecard (where granular performance metrics are aggregated, on a weighted basis to give an overall indication of performance); this is particularly relevant to councillors and would provide high level assurance that what matters most to Island residents is being satisfactorily addressed.

All of the above should be considered as part of enhancements, managed through delivery of the draft action plan.

Overseeing performance is supported by a framework of meetings, Atkins identifying that there were potentially nine different types of regular meeting being held to oversee PFI, although a number were ad hoc, or were no longer happening regularly at the time they were onsite (linked to the lack of Council capacity at the time). Atkins' key recommendations regarding meetings were:

1. All forums should have terms of reference;
2. Standing agendas;
3. Consider amalgamating meetings;
4. Ensure representation is broadly equal from both sides;
5. Ensure meetings are always chaired by the Council.

The core framework of meetings currently in place is summarised below:

- Quarterly meeting of the PFI Board; these are attended by the Head of Contract management, relevant executive member and senior representatives from Island Roads and associated entities, for example Vinci, the parent company.
- Monthly project meetings; these are attended by the Head of Contract Management, Highways PFI Contracts Programme Manager, other Council staff as required and senior representation from Island Roads.
- Monthly 'payment' meetings. Attendance at these meetings is substantively the same as for the project meetings, directly above, with the additional of the main finance representative from the Council. These are the main meeting at which the performance reports and any potential payment deductions are considered.

As can be seen the number of meetings has already been rationalised, although there may be potential to combine the 'project' and 'payment' meetings, as these already have substantively the same attendance – this should be considered. Other Atkins recommendations are in the process of being implemented, this should continue as planned – a particular issue highlighted by Council staff is the high number of attendees from Island Roads and associated entities at weekly traffic meetings, this should be addressed as a matter of priority.

As part of a separate internal audit review, we carried out in parallel with this review, focussed on the Council's arrangements to comply with the Flood and Water Act. Within that work how Island Roads performance is managed in relation to flooding incidents was explored in more detail. Island Roads are responsible for a number of duties related to flood response, for example Island Roads should attend at the site of the emergency call out within two hours of notification (per section 6.4.3.1.1 of the contract), with a specific duty to investigate at least 60 cases of incidents defined as 'other flooding' on an annual basis.

In line with the approach to monitoring Island Roads wider performance, this is 'self-reported' by Island Roads through the MIS and reports extracted from it, considered at monthly contract meetings. As identified by Atkins, there is only limited checking of the information provided by Island Roads. As failing to meet performance standards will lead to deductions from the fees paid by the Council to Island Roads, there is an incentive for fraud although we did not identify any instances where this had happened, nor was this flagged as a concern by staff interviewed to inform this review.

The proposals put forward by Atkins, for example site inspections (currently ad hoc) and reviewing reports against the MIS to ensure they are consistent have the potential to improve control over this area – while information in reports is checked back to the MIS, this is a complex and time consuming task. The Team are in the process of implementing an audit system (from Mouchel), which will make this much more straightforward; this should be progressed as planned. Until enhancements are in place this area does represent a significant financial risk for the Council, as a result this finding has been rated as high risk – once enhancements have been in place for 12 months an exercise which should be considered is comparing deductions made against those made for the first three years of the Contract, to indicate the level of deductions which could have been made if this area had been more robustly managed.

## **Risks**

If a robust performance management framework is not in place then it will be more likely that Island Roads will not be held to the level of performance specified in the Contract.

Ultimately, with payment linked to the achieved level of performance, if this is not robustly managed the Council may pay for a higher level of service than it received and Island residents will not be receiving the level of service identified as required in the Contract.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;"><b>High</b></p>	<p>The Highways PFI Contracts Programme Manager, supported as necessary by other members of the PFI Contract Management Team, escalating as necessary, will:</p> <ul style="list-style-type: none"> <li>• Ensure the recommendations made by Atkins specific to performance management are addressed; specifically ensuring that the framework to validate information provided by Island Roads is enhanced through reviewing performance reports against the MIS, utilising the new audit system once available, to ensure they are consistent and implementing sample checks of work performed, or equivalent.</li> <li>• Revisit Atkins recommendations regarding the framework and management of meetings, to ensure the underlying issues have been satisfactorily addressed.</li> </ul>	<p>Antony Cooke, Highways PFI Contracts Programme Manager</p>
		<p><b>Target Date</b></p>
		<p>November 2016</p>
		<p><b>Report reference:</b></p>
		<p>IOW- 05-01</p>



## 2. Action Plan – control design

### Finding

Atkins, a specialist engineering consultancy, were engaged by the Council to review the Highways PFI Contract in early 2015, to identify how a number of issues should be addressed. This was needed to ensure that the interface between the Council and Island Roads (the provider) is correctly managed and the Contract meets the needs of the Island for the remainder of the 25 year term.

Atkins' work was wide ranging; staff were on site for approximately nine months, up to September 2015, producing in excess of 40 reports and providing access to specialist engineering expertise – at the time Atkins staff were on site, the Council had no directly employed highway engineers.

From our discussions with the Highways PFI Contracts Programme Manager the two core issues with the PFI Contract are:

- Disagreement between the provider and the Council regarding what constitutes the Project Network. While this is specified in detail within the PFI Contract, there are elements which would normally be considered part of the Project Network which are not included in the Contract. An example was given during our fieldwork of incorrect information regarding the number of bollards present on a road. Where this is incorrectly specified in the Contract, Island Roads' view is that they are solely responsible for the identified bollards, the Council's view is that Island Roads is responsible for all bollards, regardless of whether they are individually identified in the Contract.
- How the client side interface is managed. The core issue is that, for a number of reasons, the Council found itself with insufficient capacity to manage the interface with the provider by the end of 2014. There are also a number of specific issues, for example attendance at meetings, identified by Atkins.

The first of these issues is currently the subject of ongoing adjudication. As the adjudication had not concluded at the time of fieldwork the issue remains unresolved. The second issue was the subject of two of the reports produced by Atkins:

- Performance Management Report; dated 21<sup>st</sup> April 2015.
- Staffing Structure Report; dated 11<sup>th</sup> May 2015.

Both of these documents have been provided for our review.

Regarding the Council's overarching response to Atkins' work we were provided with an early draft action plan, stemming from the two reports identified above. The early draft is currently limited to identifying the recommendations made by Atkins; we were informed that the next phase of work will be to identify existing or planned mechanisms the Council has or is planning to put in place to address the underlying issues, with further actions then identified as necessary.

This is a sensible approach; the Council has another major contract which has recently gone live, covering waste collection and disposal, along with related responsibilities which need similar skillsets, for example coastal engineering. There are obvious synergies achievable by sharing resources between these, for example in addition to engineering, legal and financial expertise. Taking this approach will also help to minimise the cost overhead of managing the two contracts, maximising efficiencies for the Council.

However to ensure that the Council achieves VfM (Value for Money) from Atkins' work, a thorough review of their reports is justified, taking much the same approach as has been taken to date with the two core reports identified above; in summary the actions which need to take place are:

- Finalise the current action plan; this is currently with the Head of Contract Management for review. Once reviewed, owners and due dates need to be identified for each of the actions.
- The remainder of the Atkins' reports need to be worked through; specifically each of Atkins' recommendations need to be considered against the underlying issue they address, on a risk basis. Where existing mechanisms are in place which address the underlying risk this needs to be identified and confirmed as satisfactory, where not, appropriate actions need to be identified. The recommendation from Atkins should be the starting point for this, moderated by synergies offered by combining elements with arrangements in place for managing the Waste Contract, to ensure that the most cost effective approach is taken.

- As actions are agreed, these should be managed through regular Team meetings, once these are established (see finding two below) and escalated for resolutions if and when issues are identified.

Realistically the Council has limited resources available. The initial step should be to identify the highest risk issues and to identify necessary actions. The Team should aim to do this within eight months, by November 2016, with issues considered lower risk addressed within 12 months, by March 2017.

### Risks

Failure to realise VfM from the investment made in Atkins' work.

Failure to address the issues identified by Atkins, increasing the likelihood that there will be ongoing issues and dissatisfaction with the Highways PFI.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;"><b>Medium</b></p>	<p>The Contract Finance and Audit officer, supported as necessary by other members of the PFI Contract Management Team, will:</p>	<p>Ged Richardson, Contract Finance and Audit officer</p>
		<p><b>Target Date</b></p>
	<p>1. Address any comments from the Head of Contract Management regarding the draft action plan.</p>	<p>1. March 2016</p>
	<p>2. Identify owners and due date for all actions.</p>	<p>2. June 2016</p>
	<p>3. Pull out recommendations from Atkins' work addressing high risk issues; where there are existing mechanisms to address the underlying risks these should be identified and confirmed with the Head of Contract Management, where there are gaps suitable actions, drawing on Atkins' recommendations, should be identified and assigned owners and due dates.</p>	<p>3. November 2016</p>
<p>4. Ensure the action plan is managed through team meetings, escalating non delivery as necessary.</p>	<p>4. April 2016</p>	
<p>5. Ensure all issues identified by Atkins are addressed.</p>	<p>5. March 2017</p>	
	<p><b>Report reference:</b></p>	
	<p>IOW- 05-02</p>	

### 3. Staffing – control design

#### Finding

The PFI Contract went live on the 1<sup>st</sup> April 2013, immediately prior to a change in political administration at the Council. Between April 2013 and December 2014 there were a number of changes in Council staffing responsible for managing the Contract and specifically the relationship with the provider, Island Roads. Ultimately by late 2014 the Council found itself with few staff who had any knowledge of the Contract and no CHIT (Chartered Institution of Highways & Transportation) qualified highway engineers.

At this point the Council engaged Atkins, a specialist engineering consultancy, to provide short term capacity/expertise to support remaining Council staff and to review current arrangements regarding managing the Contract. Atkins also made recommendations as to the arrangements which needed to be put in place to ensure the Contract is correctly managed for the remainder of its 25 year contract term. Atkins' core recommendations regarding staffing are set out in the Staffing Structure Report, dated 11<sup>th</sup> May 2015, provided for our review. This set out a range of issues that had contributed to poor performance within the contract, especially in relation to staffing, as extracted below:

- Lack of leadership;
- Not enough time to review documents;
- Risk that the Council is not adjusting Island Roads as per contract (i.e. making payments/deductions in line with performance);
- Too many Member enquiries to deal with;
- Confused roles and responsibilities;
- Initial estimates for designs unrealistic;
- Large volume of Network Integrity Report enquiries;
- Large volume of Strategies and Plans to approve;
- Communications work very time consuming – media, FOI's MP letters, etc;
- Limited technical capability.

The report goes on to make detailed recommendations as to the staffing/resourcing which should be put in place to address the issues above. In summary this suggests:

- An engineering team;
- A contract management team;
- A valuations' team;
- A quality and performance team.

The above structure envisages 18.5 FTEs to manage the Contract on a long term basis, with additional 'call off' arrangements in place to provide specialist support to each team as necessary. The Council has used the Atkins' recommendations as a starting point, with the structure reporting to the Head of Contract Management as outlined below planned:

- Four distinct teams, all reporting to the Head of Contract Management, covering Highways PFI, (including coastal and drainage), Waste (including closed landfills), Transport (to school transport) and a combined team, managing contracts to support Adult and Children's social care.
- An engineering team, headed by a principal engineer, containing two specialist highway engineers (these posts were recruited to late 2015); this team will also contain a dedicated coastal engineer and an asset technician, primarily to support the highway engineers.
- A contract management team (the core Highways PFI identified above), containing the contract manager, supported by a programme officer and part time assistant to provide administrative support.
- Two officers, covering finance/audit and legal, who will split their time between supporting PFI and Waste.

In addition to the above there are also likely to be some responsibilities which transferred to Island Roads in 2013 which will come back to the Council during 2016, which will potentially reduce the level of payments made. Primarily this is to address duplicated effort, for example statutory roles covering permanent traffic regulation orders (TROs) , such as where yellow lines are needed. Currently Island Roads make recommendations regarding these, which are then reviewed by the Council who make the final decision.

The structure above is still being consulted on. However as there are no job losses anticipated, the Council is confident that the structure will be in place by May 2016; we were also informed that once the team structure above is in place, regular team meeting will be held, as a precursor a combined SMT (Senior Management Team), comprising all of the current team managers, started to meet in March 2016. This should continue as planned, specifically team meetings should be used as the primary forum to oversee delivery of the action plan, covered in finding one, at the operational level, with any issues identified escalated to senior management.

Specific to the Highways PFI and related areas, the Council is planning to implement teams comprising a total of 8.5 FTEs. While a significant improvement on the capacity which has been available for the last three years, it is less than recommended by Atkins, who as a specialist in this area are well placed to identify the level of staffing required; it is also likely to be significantly less than is in place to manage similar PFI contracts elsewhere, for example in Hounslow and Birmingham. The Council's financial constraints are well known. However the Highways PFI is the largest contract the Council has ever let, in excess of £725 million over 25 years; capacity will need to be monitored carefully and if necessary extra staffing should be considered.

We were provided with the following job description related to the structure above for review:

- Highways PFI Contracts Programme Manager, dated April 2013;
- Contract Support & Programme Officer, dated April 2013;
- Contract Administrator, dated April 2013;
- Principal Coastal Engineer, dated May 2013;
- Highway Engineer – Capital projects, dated June 2015;
- Highway Engineer – Audit and Technical compliance, dated June 2015;
- Contract Monitoring and Asset Manager, dated October 2012;
- Coastal Engineering Technician, dated May 2013;
- Highways PFI Contracts Lawyer, dated April 2013.

Apart from the two highway engineer job descriptions all of the above are overdue review; while the majority are substantively correct, a number make references to activities specific to the 'mobilisation phase' of the PFI contract. All job descriptions should be reviewed and updated, to ensure they are reflective of current practice.

Related to 'staffing' Atkins also make recommendations regarding call off arrangements which should be put in place to ensure third party support can be sourced quickly and cost effectively if required, as below:

- Engineering;
- Contract Management;
- Valuations;
- Quality and Performance.

As above, the Council has recruited two qualified and experienced highway engineers.. Regarding contract, quality and performance management, the Team has a number of qualified and experienced staff, for example with legal and financial expertise. As above, Atkins recommended a specific team to manage valuation, covering the areas below:

- Commercial evaluation of changes;
- Monthly Service Provider accounts;
- Financial monitoring;

- Provision of scheme and other estimates;
- Evaluating Service Provider quotations;
- Raising purchase orders;
- Scrutinising costs;
- Accruals and de-accruals;
- Third party income.

We were informed that the need for this team is primarily linked to changes to the Project Network, for example as a result of additional work being accrued. In practice this has not happened to date (see finding four below). While this may increase over the remaining term of the Contract, the Team is confident that they have sufficient skills to manage this area, within current resourcing. However call off services are always likely to be cheaper than waiting until services are required and then launching a procurement exercise; putting call off arrangements in place for all of the areas recommended by Atkins should be considered.

**Risks**

If appropriate staffing, with the correct skills and with access to appropriate third party support are not in place, then the Council is unlikely to be able to maximise the service provided by Island Roads. Underperformance will be unlikely to be identified and addressed at the earliest opportunity, ultimately the Council may fail to realise VfM from its contract with Island Roads.

If up to date job descriptions, which are reflective of practice, are not in place then they may be a lack of clarity regarding where responsibilities lie, ultimately gaps may exist in arrangements which will increase the likelihood that the relationship is not correctly managed.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;"><b>Medium</b></p>	<p>The Head of Contract Management will:</p> <ul style="list-style-type: none"> <li>• Progress implementing a suitable team structure to manage the Highways PFI as planned.</li> <li>• Revisit the Atkins recommendations regarding staffing and skillsets to ensure that the intended team is sufficient, both in terms of numbers and skills, to manage the Contract on an ongoing basis.</li> <li>• Revisit the Atkins recommendations regarding third party support to ensure cost effective support can be quickly sourced, if required.</li> <li>• Review and update job descriptions, once the new Team is in place.</li> </ul>	<p>Bill Murphy, Head of Contract Management</p>
		<p><b>Target Date</b></p>
		<p>May 2016</p>
		<p><b>Report reference:</b></p> <p>IOW- 05-03</p>

## 4. Call Off Services – control design

### Finding

A detailed catalogue of additional services, for example temporary traffic controls, is specified in Schedule 17 of the PFI Contract. This categorises additional services into three categorisations by value (i.e. high, medium and low), with a defined process for how each should be managed. Approximately £1 million of additional services has been purchased from Island Roads in the first three years of the Contract, primarily linked to the grant funded local sustainable transport initiative, for example cycle tracks; all additional services to date have been categorised as low value, the process for this category at a high level being as below:

- Request made;
- Provider responds within five days with cost, to not exceed catalogue price;
- Work and price agreed;
- Payment made next month.

The main issues with additional services are quality control, which would be addressed by sample checking, as covered in finding three above and accruals (where ‘assets’ stemming from call off work are added to the Highway Network, to be maintained by Island Roads in return for an increase in payments made). Essentially these two items are linked; if an item is accrued to the network then essentially the ‘risk’ of substandard work being completed would sit with Island Roads, as they would take on responsibility for maintaining the ‘addition’. However, primarily due to the additional cost, as above, no significant items to date have been accrued to the network. Two changes should be progressed:

1. Quantifying criteria regarding whether items should be accrued. Specifically, although it would entail additional costs, over the term of the Contract it may prove lower cost to accrue items to the network in some circumstances, as opposed to the Council directly covering the cost of ongoing maintenance of the ‘asset’.
2. Quantify criteria as to when additional work carried out by Island Roads should be checked; for example nonstandard work which is not being accrued to the network.

### Risks

Poor quality work not being identified, due to reliance on Island Roads self-reporting.  
Higher costs to the Council in the long term, due to items not being accrued to the network.

Finding rating	Agreed actions	Responsible person / title
<b>Medium</b>	The Highways PFI Contracts Programme Manager, supported as necessary by other members of the PFI Contract Management Team, escalating as necessary, will: <ul style="list-style-type: none"> <li>• Define quantified criteria to decide when accruing to the network is the best value option for the Council.</li> <li>• Define quantified criteria as to when additional work carried out by Island Roads should be quality checked.</li> </ul>	Antony Cooke, Highways PFI Contracts Programme Manager
		<b>Target Date</b>
		November 2016
		<b>Report reference:</b>  IOW- 05-04

# Appendix A: Basis of our classifications





Finding rating	Effect on Service	Embarrassment / reputation	Personal Safety	Personal privacy infringement	Failure to provide statutory duties/meet legal obligations	Financial	Effect on Project Objectives/ Schedule Deadlines
<b>Critical</b>	<p>A finding that could result in a:</p> <ul style="list-style-type: none"> <li>Major loss of service, including several important areas of service and /or protracted period. Service Disruption 5+ Days</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Adverse and persistent national media coverage</li> <li>Adverse central government response, involving (threat of) removal of delegated powers</li> <li>Officer(s) and/or Members forced to resign</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Death of an individual or several people</li> </ul>	<p>A finding that could result in:</p> <p>All personal details compromised/ revealed</p>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Litigation/claims/ fines from Department £250k +</li> <li>Corporate £500k +</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Costs over £500,000</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Complete failure of project/ extreme delay – 3 months or more</li> </ul>
<b>High</b>	<p>A finding that could result in a:</p> <ul style="list-style-type: none"> <li>Complete loss of an important service area for a short period</li> <li>Major effect to services in one or more areas for a period of weeks Service Disruption 3-5 Days</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Adverse publicity in professional/municipal press, affecting perception/standing in professional/local government community</li> <li>Adverse local publicity of a major and persistent nature</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Major injury to an individual or several people</li> </ul>	<p>A finding that could result in:</p> <p>Many individual personal details compromised/ revealed</p>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Litigation/claims/fines from Department £50k to £125k</li> <li>Corporate £100k to £250k</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Costs between £50,000 and £500,000</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Significant impact on project or most of expected benefits fail/ major delay – 2-3 months</li> </ul>

<b>Finding rating</b>	<b>Effect on Service</b>	<b>Embarrassment / reputation</b>	<b>Personal Safety</b>	<b>Personal privacy infringement</b>	<b>Failure to provide statutory duties/meet legal obligations</b>	<b>Financial</b>	<b>Effect on Project Objectives/ Schedule Deadlines</b>
<b>Medium</b>	<p>A finding that could result in a:</p> <ul style="list-style-type: none"> <li>Major effect to an important service area for a short period</li> <li>Adverse effect to services in one or more areas for a period of weeks Service Disruption 2-3 Days</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Adverse local publicity /local public opinion aware</li> <li>Statutory prosecution of a non-serious nature</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Severe injury to an individual or several people</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Some individual personal details compromised/ revealed</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Litigation/claims/fines from Department £25k to £50k</li> <li>Corporate £50k to £100k</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Costs between £5,000 and £50,000</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Adverse effect on project/ significant slippage – 3 weeks–2 months</li> </ul>
<b>Low</b>	<p>A finding that could result in a:</p> <ul style="list-style-type: none"> <li>Brief disruption of important service area</li> <li>Significant effect to non-crucial service area Service Disruption 1 Day</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Contained within section/Unit or Directorate</li> <li>Complaint from individual/small group, of arguable merit</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Minor injury or discomfort to an individual or several people</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Isolated individual personal detail compromised/ revealed</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Litigation/claims/fines from Department £12k to £25k</li> <li>Corporate £25k to £50k</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Costs less than £5,000</li> </ul>	<p>A finding that could result in:</p> <ul style="list-style-type: none"> <li>Minimal impact to project/ slight delay less than 2 weeks</li> </ul>
<b>Advisory</b>	A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.						



## Report classifications

<b>Findings rating</b>	<b>Points</b>
<b>Critical</b>	40 points per finding
<b>High</b>	10 points per finding
<b>Medium</b>	3 points per finding
<b>Low</b>	1 point per finding

<b>Report classification</b>	<b>Points</b>
 <b>Low risk</b>	6 points or less
 <b>Medium risk</b>	7– 15 points
 <b>High risk</b>	16– 39 points
 <b>Critical risk</b>	40 points and over

# Appendix B: Terms of Reference

## Background and Scope

The Highways PFI is the most significant service outsourcing, both in terms of cost and duration (approximately £150 million over 25 years), carried out to date by the Council. The contract is still at an early stage and there has been some dissatisfaction, both from the provider and the Council, with the way that it is working, for example the exact scope of work included in the Contract; this situation has been exacerbated from the Council's perspective both by a lack of capacity and a number of changes in key staff, responsible for managing the client interface.

Due to the factors above the Council commissioned external review of the Contract from a specialist engineering consultancy. This included:

- Identification of all outstanding issues.
- Work with both the Council and Provider to understand their perspectives.
- A recommended way forward for each issue.

A Highways Board meeting on 2nd November resolved to move to a formal adjudication process under the contract on the following matters.

- Definition of the Project Network.
- Responsibility for costs associated with off project network street cleansing.

This process has now commenced.

Due to the above our planned reviews of the Highways PFI contract have been postponed a number of times, to ensure that it is of greatest value to the Council. The external review is now complete and the Council is in the process of responding, to ensure that all outstanding issues are resolved to everyone's satisfaction. At a high level our review will cover three areas:

- The Council's response to the external review, helping to ensure that this is responded to appropriately by the Council.
- That there are appropriate mechanisms in place to manage the Contract on an ongoing basis.

That there are arrangements in place regarding any additional services required from the Contractor as a managed process.

The control objectives and potential related risks included in this review are:

	<b>Control objective</b>	<b>Potential risks</b>
1	<b>Outstanding Issues</b> <ul style="list-style-type: none"><li>• The Council has produced an action plan, or equivalent, addressing all of the issues identified through the external review of the PFI contract.</li><li>• All actions have assigned ownership and due dates.</li><li>• Progress of the action plan is reported to and monitored by suitable senior officer and member forums.</li><li>• Any issues related to insurance have been identified and addressed, through the external review and action plan.</li></ul>	<p>If the external review has not been responded to with a correctly managed action plan, addressing all of the issues identified, then the value of the external review will be less, ultimately issues are likely to remain unaddressed, leading to ongoing dissatisfaction with the PFI contract.</p> <p>If issues have not been fully identified and addressed by the external review, for example insurance, then ongoing gaps in arrangement will be more likely.</p>

	<b>Control objective</b>	<b>Potential risks</b>
	<ul style="list-style-type: none"> <li>How insurance is covered and income streams are maximised is addressed in the action plan.</li> </ul>	
2	<b>Contract Management</b> <ul style="list-style-type: none"> <li>A suitably qualified and experienced team are in place at the Council to manage the Contract.</li> <li>Quantified performance standards have been agreed, between the Council and the provider.</li> <li>Sufficient reporting is in place, to evidence that performance standards are being met.</li> <li>A forum is in place, with appropriate membership, which meets at regular intervals, to manage the interface between the Council and the provider and hold the provider to account that the specified level of service is being delivered.</li> </ul>	<p>If the Council does not have a correctly resourced Team in place to manage the Contract then the provider will less likely to be held to the terms of the contract, ultimately the quality of the service and value for the Council will be less likely to be achieved.</p> <p>If suitable mechanisms are not in place to manage the client interface, for example a forum with appropriate membership and quantified performance metrics, then the provider will be less likely to have a clear understanding of the required level of performance and be held to it.</p>
3	<b>Call Off Arrangements</b> <ul style="list-style-type: none"> <li>A schedule of fees has been agreed for additional highways related work the Council may require, for example highways design related work.</li> <li>Appropriate arrangements have been made to manage the delivery of additional work the Council may require; specifically specification, quality assurance and payment arrangements.</li> <li>Arrangements are in place to ensure that call off arrangements are only used for services not included in the 'core' contract.</li> </ul>	<p>If an appropriate framework is not in place to manage additional services that the Council may require then time and effort may be wasted in procuring it from additional third parties, potentially at greater cost.</p>

## Audit approach

Our audit approach is as follows:

- Obtain an understanding of Highway's PFI contract management processes and controls through discussions with key personnel and review of systems documentation.
- Evaluate the design of the controls in place to address the key risks.
- Test the operating effectiveness of the key controls.

## Internal audit team

<b>Name</b>	<b>Title</b>	<b>Role</b>	<b>Contact details</b>
Emma Butler	Director	Engagement Leader	<a href="mailto:emma.butler@uk.pwc.com">emma.butler@uk.pwc.com</a>
Dan Deacon	Manager	Engagement Manager	<a href="mailto:daniel.r.deacon@uk.pwc.com">daniel.r.deacon@uk.pwc.com</a>
Geraint Newton	Senior Associate	Auditor	<a href="mailto:geraint.newton@uk.pwc.com">geraint.newton@uk.pwc.com</a>

## Key contacts – Isle of Wight Council

<b>Name</b>	<b>Title</b>	<b>Contact details</b>
Bill Murphy	Head of Contract Management	<a href="mailto:bill.murphy@iow.gov.uk">bill.murphy@iow.gov.uk</a>

## Timetable

<b>Fieldwork start</b>	<b>14<sup>th</sup> December 2015</b>
<b>Fieldwork completed</b>	<b>29<sup>th</sup> January 2016</b>
<b>Draft report issued to Head of Internal Audit</b>	The draft report will be issued to the Head of Internal Audit within 10 working days of the completion of fieldwork.
<b>Head of Internal Audit response due by</b>	The Head of Internal Audit will provide comments on draft report within 2 working days of receiving the report.
<b>Draft report issued to Audit Sponsor</b>	The draft report will be issued to the Audit Sponsor within 10 working days of the completion of fieldwork.
<b>Management response due by</b>	The Audit Sponsor will provide the Head of Internal Audit with a complete written response to the internal audit report within 10 days of receipt of the draft report. Where there is disagreement over the report or recommendations, these must be resolved within 10 working days of the problem being highlighted.
<b>Final report issued by</b>	Final report will be issued to the Head of Internal Audit for issue to the Audit Sponsor 5 working days of receiving the management response.
<b>Client satisfaction survey</b>	A client satisfaction survey will be issued following each audit. You may wish to consider this throughout the audit.

Agreed timescales are subject to the following assumptions:

- All relevant documentation, including source data, reports and procedures, will be made available to us promptly on request
- Staff and management will make reasonable time available for interviews and will respond promptly to follow-up questions or requests for documentation

## Information requested

Below is a list of information we expect to have available on the first day of the audit:

- Outputs from Atkins review.
- Action plans, setting out the Council response to the Atkins review.
- Details of how progress against the action plan is monitored and reported, for example agendas and minutes of relevant meetings.
- Details regarding the insurance position, if not covered in documents requested above.
- Structure chart and job descriptions for team managing the PFI contract.
- Details regarding how the Contract is managing on an ongoing basis; for example performance metrics, agendas and minutes of relevant forums.
- Details regarding call off arrangements.

*This is not a comprehensive list of the documentation which may be required, but production of the above documents is advisable at the outset of the audit.*

# Appendix C: Limitations and responsibilities

## Limitations inherent to the internal auditor's work

We have undertaken the review of Highways PFI contract management controls subject to the limitations outlined below.

### Internal control

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

### Future periods

Our assessment of controls relating to the Highways PFI contract is for controls effective from April 2015 to February 2016. Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

## Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

