

Isle of Wight Council

Internal Audit Report 2016/17

Highways and Waste Contract Management
follow up

September 2017

FINAL



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Distribution List

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1. Executive summary

Report classification  High Risk	Trend  Consistent with our 2015/16 review.	Total number of findings					
			Critical	High	Medium	Low	Advisory
		Control design	0	2	2	0	0
		Operating effectiveness	0	0	0	0	0
		Total	0	2	2	0	0

Summary of findings:

This combined review of the Council's approach to managing the Highways PFI and Waste contracts, was scheduled to assess the progress made in addressing the issues identified through our 2015/16 standalone reviews of each. Our work was structured as below:

- *PFI Action Plan*: assessing the progress made regarding action implementation and wider enhancements to the action plan.
- *Staffing*: confirming that an appropriately resourced team is in place to manage the Highways PFI and Waste Contract, with access to finance and legal expertise.
- *Call Off Services (PFI)*: confirming that additional services commissioned from Island Roads are correctly managed.
- *Call Handling (Waste)*: confirming that the volume of Waste related calls is being monitored and this is not having an excessive impact on overall call wait times.

At a high level the Council is confident that the approach to managing the Highways PFI contract has improved. Specifically Island Roads is being more robustly managed at the strategic level, milestone payments for Milestone 6 (due in April 2016) and Milestone 7 (due in September 2016) have been withheld due to unresolved issues, saving the Council £172,000 a month from scheduled uplifts to the unitary charge – prior to 2016 no uplift payments had been withheld. There is also evidence that Island Roads are being subject to greater challenge at the operational level; specifically we were informed that all additional items of work commissioned from Island Roads are now inspected by the two Highway Engineers recruited by the Council at the end of 2015. Although there is a lack of documented evidence to support this inspection Larger works are robustly managed by the pre-PFI Head of Highways (commissioned by the Council on an ad hoc basis to project manage larger works).

Regarding Waste calls into the Contact Centre, these are being closely monitored. While the new Waste Contract has led to a significant increase in call volumes this has not had a major impact on Waste specific or general call wait times.

We noted that the majority of the actions stemming from our 2015/16 review regarding the Highways PFI are partially implemented. There remains a contract management resourcing issue with Highways PFI and Waste and, linked to this (specific to Highways PFI), a general lack of formality and record keeping. For example, what is actually inspected regarding additional pieces of work needs to be documented, evidenced consistently and a more robust regime of management reporting put in place.

We identified four detailed findings, summarised below:

PFI Action Plan: since our last review there have been improvements to the oversight of Island Roads' work and, at a high level, some progress has been made with progressing the action plan responding to Atkins' reports (Atkins is a specialist engineering consultancy, which was commissioned by the Council in January 2015, to provide support and make recommendations as to how the Council's PFI client function should be enhanced) and progress wider enhancements to the way that the PFI is managed; for example we were informed that all Atkins' reports have now been reviewed and that the Head of Contract Management has verbally approved the revised action plan. There has also been some monitoring of progress through informal meetings with the Head of Contract Management in attendance, although no minutes of these have been retained.

The action plan itself requires improvement. Specifically:

- The majority of 'actions' are more correctly considered 'recommendations' and need to be translated into actual actions. For example recommendations where the need to improve risk management is highlighted could be translated into the production of risk registers, with mitigations and appropriate oversight.

- A number of ‘recommendations’ overlap and are likely to be addressed by combined actions. For example there are a number of references to improving ‘performance management’. Substantively all of these could be addressed by formalising, documenting, consistently exercising and overseeing the work of the Team.
- Some actions may be unrealistic with the available level of resourcing. For example sample testing 5% of entries in Confirm (the system used by Island Roads to manage their work). The action plan needs to be revised, to ensure that the actions sufficiently detailed, clear and realistic.
- All actions have effectively reached their due date (November 2016), with only limited evidence available of actions being addressed; this is indicative that the originally scheduled implementation dates were unrealistic.

Following improvement to the current action plan, the oversight and reporting of progress with the action plan needs to be improved, for example through collating evidence of progress and circulating the action plan with the currently blank progress column updated. We have raised this area as a **high risk** finding.

PFI Documented Processes: while we were provided with some evidence of progress with the PFI Action Plan, the majority of the Team’s work remains undocumented for the areas tested and needs to be formalised, documented, consistently exercised and overseen. For example processes as to how Confirm is used and Island Roads work is physically inspected need to be documented, with evidence of the Contract Monitoring Team’s work retained in a consistent format.

Due to the current largely informal approach it has not been possible for us to complete our scheduled sample testing of the PFI Action Plan, due to the lack of sufficient evidence to support assertions made to us during our fieldwork. We have raised this area as a **high risk** finding.

Staffing and Third Party Support (PFI and Waste): the intention at the time of our 2015/16 review to implement a combined Highways PFI and Waste Contract Management Team is no longer being progressed, largely due to a wider restructure linked to the creation of the new ‘Place’ directorate equivalent. The issues which the planned combined Team were intended to address, specifically ensuring the management of both Highways PFI and Waste are supported by a correctly resourced and skilled Team, have the potential to be addressed by this wider restructure. For example bringing in staff from Commercial and Regulatory services with relevant skills, such as contract management and environmental enforcement; the new structure is planned to be in place during 2017.

As part of this process, the key areas which need to be addressed are: reviewing and updating job descriptions, to ensure they are reflective of responsibilities; cross skilling to reduce the reliance on key members of staff, for example regarding legal and financial expertise; considering putting in place call off contracts for access to third party financial and legal expertise – subsequent to the completion of our fieldwork we were informed by the Head of Contract management that a call off contract for legal services is at the evaluation of tender stage; and ensuring that appropriate succession planning, potentially formalised in a Workforce Development Plan, is put in place. We have raised these areas as a **medium risk** finding.

Call Off Services (PFI): since 1st April 2016 approximately £400,000 of extra work (above and beyond the core contract) has been commissioned from Island Roads, comprising of approximately 30 individual pieces of work, for example additional road crossings (up to the point of our fieldwork in December 2016). Four larger projects have also been commissioned, for example the works on St George’s Way, at the termination of the Pan link road. No items have been accrued to the network since the 1st April 2016. The agreed actions in our 2015/16 report were, in summary, to define quantified criteria to identify when additional works would best be accrued to the network (to minimise cost to the Council) and quantified criteria as to when and how additional works should be inspected. The two items are linked, for example if an additional item is not accrued to the network, the ongoing cost of its maintenance sits with the Council, therefore it is imperative that it is completed to a high standard to minimise ongoing maintenance costs. Subsequent to the completion of our fieldwork we were informed by the Head of Contract Management that a number of workshops have been held, both internally and with Island Roads, with further workshops planned to develop how best to manage this area.

While neither of the 2015/16 actions have been implemented, we were informed that the two Highways Engineers in the Team substantively inspect all additional items of work commissioned by the Council from Island Roads, with substandard work robustly challenged. While this is an improvement on the position at the time of our last review the

approach would benefit from being formalised to provide evidence and permit oversight of the Team's work. Regarding the larger projects we note that these have been robustly managed by the ex-Head of Highways. However a consistent filing structure should be agreed for these larger projects. We have raised this area as a **medium risk** finding.

In addition to the primary focus of the this review on the Highways PFI we also reviewed arrangements for managing potential 'spikes' in waste related call volumes in the Council's contact centre. We were provided with detailed statistics regarding call volumes and wait times, covering both general and Waste specific calls.

The new Waste Contract did have a significant impact on call volumes managed by the contact centre during 2016/17, calls increasing by 70,463 compared to the same period in 2015/16. However this was largely in response to the changes in collection arrangements associated with the new contract. However, the statistics provided for our review, identify that the increase in calls coming into the Contact Centre has had only a minimal impact on call wait times – in the peak week, 24th April 2016, average call wait times did not exceed 15 minutes with 8,658 Waste related calls received in that week, compared to an average (excluding the three peak weeks) of a four minute wait and an average volume of 1,422 calls per week. The key area which needs to be carefully managed is ensuring that the contact centre is aware of any upcoming changes which could impact on call volumes. We were informed by the Head of Contract Management that the waste and contact teams are in regular contact and that the contact centre team will be given advance notice of any future changes which could lead to an increase in call volumes.

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

Management Response

It is disappointing that the overall finding remains at high risk in respect of the Highways PFI contract as has been covered in the detail of the audit and evidence provided the Highways PFI contract is an immensely complex contract covering a significant area of activity which contains a vast range of complex performance management standards and a complex method for assessment of performance. The report accepts that at a strategic level that the approach to management has improved and that the really key areas of performance in respect of Milestone payments has been “ more robustly managed” and this remains the case.

The risk finding appears to be heavily driven by lack of progress on the action plan that was recommended from the initial audit . However between the first audit and the repeat audit the lack of progress on what was probably always an ambitious plan can be explained by the diversion of resource and particularly management resource to continuing to resolve a range of contract interpretation issues with the Service provider.

This position was taken to ensure that the various long term financial risks of contract interpretation could be contained. At the same time the council was also having to manage the impact of the introduction of the new waste contract that is briefly referred to within the report. This also has involved considerable management resource given the need to procure a new subcontractor due to the previous contractor Energos entering administration in mid 2016. This exercise coincided with the period during which the PFI action plan was to be developed. The new subcontractor was procured in April 2017 but the period involved in dealing with this was extensive given the need to undertake correct procurement and technical and financial due diligence.

2. Detailed current year findings

1. PFI Action Plan – control design

Finding

The overarching action plan is based largely on content extracted from the original Atkins' reports. Effectively it is 'owned' by the Head of Contract Management and monitored informally, as detailed below. The current status of the overarching action plan is as follows:

- We were informed by the Contract Management Officer that all Atkins reports have been reviewed and the action plan updated accordingly. No evidence of this could be provided.
- The revised action plan has been approved verbally by the Head of Contract Management, but there was no evidence for this.
- Individuals ("action owners") and due dates are identified for all recommendations, however all actions have the same due date, which had been reached at the time of our fieldwork (see below).
- There have been a small number of meetings with the Head of Contract Management in attendance where progress regarding the action plan has been discussed, however these were unminuted and therefore we could not validate that they had occurred.

We also noted that a progress column has been added, to allow actions to be tracked, however it has not been filled in. The key steps which need to be taken now are:

- The majority of the 'actions' would more accurately be termed recommendations (largely directly extracted from the Atkins reports). These need to be translated into actual actions. For example two of the recommendations (regarding Independent Certification and the Technical Advice Authority) reference the need to identify and manage associated risks. These recommendations should be translated into the production of a risk register, with appropriate mitigations, ownership and due dates, to be managed as a standing item at Team meetings with escalation by exception.
- We were informed that a number of actions have been addressed, for example 'IWC should direct any formal assurance activities against Island Road Service but recognise that Ringway Island Roads will be the major provider of the information required'. The progress column needs to be updated accordingly, for this and other actions which have been addressed.
- A number of the recommendations potentially overlap and could be addressed by the same action. For example 'IWC should adopt a layered approach to gaining assurance that IR are fully meeting all of their contractual obligations' and 'IWC create an effective supplier performance monitoring and management regime'. Essentially this equates to documenting and, where necessary, formalising the work of the Team.
- Some of the recommendations may be unrealistic. For example 'IWC reviews around 5% of records in Confirm each month to check their contractual compliance with the percentage varying depending on the findings' (Confirm is the system used by Island Roads to 'manage' their work, the Contract Management Team having full access to the system). We were informed that work items run into 'thousands' each month, with around 50 currently checked by the Highways PFI Contracts Programme Manager. Where recommendations are unrealistic, as part of the process of refining the action plan covered in the first bullet above, recommendations should be translated into realistic actions. Specific to this recommendation, the level of review needs to be realistic, with an agreed methodology used to identify records which will be reviewed.

Once the action plan has been refined as above, each action needs to be assigned a unique identifier (to aid tracking), agreed ownership and a realistic due date - currently all actions are identified as due in November 2016. To help identify appropriate implementation dates, each action also needs to be considered from a risk perspective and prioritised accordingly. There are also a number of actions which should be relatively quick to address, comprising largely of requesting information from Island Roads, for example:

- There are a group of recommendations covering ‘certifications’. This links back to a potential issue identified by Atkins regarding Island Roads not automatically holding certifications held by other members of the Vinci/Ringway Group. Atkins referenced a number of certifications but the most pertinent are Quality Management System, ISO 9001 and Green Waste, ISO 14000 – while the contract does not require Island Roads to hold these certifications it does require their processes to be aligned with them; Atkins’ primary recommendation was that the Council seek assurances from Island Roads that this is the case.
- There are a number of recommendations linked to Island Roads’ programme of internal audits. Essentially these equate to requesting Island Roads’ Internal Audit Plan and sight of reports produced which identify significant issues.

Regarding monitoring of progress with the action plan, this could be improved by considering it at the PFI Team’s meetings. At a minimum a single officer should take ownership for the action plan and collating evidence from action owners, an update then being given to the Head of Contract Management monthly, including any actions which have reached their due dates without being implemented.

Risks

If the issues with the IR contract are not effectively tracked and managed via an action plan then contract performance may not be as required, paid for or meet the needs of Island residents.

Without a robustly managed response to the Atkins report recommendations the Council may not fully realise the value of Atkins’ work in identifying improvements needed in the performance of IR.

Without robust management of the action plan actions may not be completed in a timely manner, with the underlying risks/issues remaining unaddressed.

Finding rating	Agreed actions	Responsible person / title
High	<p>The Contract Management Officer, collaborating with other members of the Team, will revisit the requirements for managing the client interface with Island Roads, review current practice, identifying gaps/enhancements, document in a work plan and manage delivery of the work plan robustly.</p> <p>1. Agree with the Head of Contract Management how progress is to be monitored and reported; potentially through team meetings or alternatively through a brief monthly report.</p>	Bill Murphy
		Target Date
		November 2017
		Report reference:
		IOW- 11-01

2. PFI Documenting Processes – operating effectiveness

Finding

Our intention was to sample test a number of actions to confirm that sufficient progress was being made to ensure actions were completed by their scheduled delivery date. This was not possible due to the fact that, as above, many of the actions are worded as recommendations, some are unrealistic, the work of the Team is still largely undocumented (i.e. documentation is not available to support assertions), all actions have reached their scheduled completion dates and that ultimately it is not possible to link the enhancements which have been made to specific actions on the action plan. It is not possible to confirm definitely that any of the recommendations have been fully addressed. As an alternative we have met with senior members of the Team to identify the mechanisms which are in place to hold Island Roads to the agreement. These are summarised below:

- We were informed by the Head of Contract management that the Highways PFI Contracts Programme Manager inspects all items were Island Roads claims non failure and physically reconciles this back to information in the Confirm system.
- Monthly finance meetings: this is the key control. An ‘exceptions’ report (two months in arrears) is considered at this forum. In this report Island Roads self-identify performance measures they have not met and deductions to be made from the unitary charge.
- Ad hoc inspections: the two Highways Engineers inspect Island Road’s work and flag exceptions which need to be addressed.
- Following up on complaints made by members of the public, for example when Island Roads may have carried out work to a poor standard.
- Challenging Island Roads where there is disagreement regarding what is covered by the contract.

Examples of all of the above were provided for our review. We were also informed that the Mouchel Audit Tool (to enable information from Confirm to be linked more clearly to performance standards) has been used once and that further use is planned. While examples of the Team challenging and holding Island Roads to account are available, what is missing is documented processes. This would include documented processes which are followed consistently, evidenced, subject to management oversight and reported to senior management. Going into detail regarding how this should be addressed is beyond the scope of this report, however key points which need to be addressed are summarised below:

- A documented, consistent approach to what should be physically inspected (i.e. rather than relying on Confirm), for example an agreed sample size, selected on a risk basis.
- How the work of the Team should be documented, for example checklists, consistent filing structures and spreadsheets (using for oversight/reporting), linked to underlying evidence.

Risks

Without a consistent, documented approach to managing Island Roads there is an increased likelihood that underperformance will not be identified, service quality will not be maximised and relevant deductions made from the unitary charge, leading to higher costs for the Council.

If not formalised, in the event of future dispute, records will not be available to support decisions made at contract meetings.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;">High</p>	<p>The Head of Contract Management will ensure that the areas below are addressed in the work plan identified under finding one</p> <ul style="list-style-type: none"> • Design and document consistent processes to be used when overseeing the work of Island Roads, specifically covering validation/checking of information in Confirm and physical inspection of work carried out. • Implement a consistent approach to documenting and reporting the work of the Team. 	<p>Bill Murphy, Head of Contract Management</p>
		<p>Target Date</p>
		<p>November 2017</p>
		<p>Report reference:</p> <p>IOW- 11-02</p>

3. Staffing and Third Party Support (PFI and Waste) – control design

Finding

Atkins (the engineering consultancy, engaged by the Council in early 2015 to provide short term support and identify options as to how the Highways PFI should be resourced and managed longer term) made a number of recommendations regarding staffing. At a high level this involved increasing the size of the Team and ensuring that either the Team contained correctly skilled staff, for example highways engineers and access to specialist finance and legal expertise, or had easy access to appropriate third party support.

At the time of our 2015/16 review the Council had already partially responded, by employing two highway engineers and reassigning finance and legal staff from the Waste Contract procurement, to support the delivery phases of both Highways PFI and Waste. The intention in 2015/16 was to formalise this arrangement, putting in place a joint Team to manage Highways PFI and Waste.

The wider Council continues to be under significant financial pressure and the intention to set up a combined Team has been overtaken by events. Organisationally both Highways PFI and Waste now sit under 'Place'. Commercial and Regulatory services also sit under Place, areas which potentially have synergies with Highways PFI and Waste, for example regarding contracts managed by Commercial Services and the environmental enforcement elements of Regulatory Services. These synergies have been recognised by the new Head of Place, with the intention that all of these areas, Highways PFI, Waste, Commercial and Regulatory services, will be restructured to put in place combined teams. The aim would be to both realise efficiencies and ensure that there are appropriate resourcing and skills available to manage the Highways PFI and Waste Contract long term.

How the restructure of Place will proceed is at an early stage, however the intention is to have a revised structure in place by during 2017; this should continue as planned. Key elements which need to be considered as part of this process are summarised below:

- *Job descriptions:* we note that the job descriptions for the core Waste and Highways PFI key officers are out of date. While simplistically these need to be reviewed and updated, to ensure they are reflective of responsibilities, we note that, while not reviewed as part of our fieldwork, this is also likely to be the case for staff in Commercial and Regulatory services. Once staff responsibilities have been clarified, the job descriptions for all impacted staff should be reviewed and revised accordingly.
- *Cross skilling:* the employee agreements signed by the predecessor Waste Procurement Team have now expired. While replacement agreements are unlikely to be realistic, an element of cross skilling needs to be planned for as part of the restructure. Currently one member of staff has legal expertise and one member of staff has finance expertise, to cover both Waste and Highways PFI makes the Council over reliant on these members of staff and needs to be addressed.
- *Third party support:* historically both Waste and Highways PFI have made significant use of third party support, largely on a 'one off' basis, for specific pieces of work.. Stemming from the Energos replacement (Energos were a second tier technology provided to Amey, who have gone into administration) and the revised financial model, further one off support is also likely to be necessary; this should be procured, as planned. Subsequent to the completion of our fieldwork we were informed by the Head of Contract Management that this happened as planned. More widely, particularly with such a small team, while there will be internal expertise available for some areas from other Council teams, for example the Technical Finance Manager has provided advice on capital financing, call off type contracts should be investigated across the board (i.e. technical, finance and legal). These would help mitigate the current overreliance of key members of staff identified directly above.
- *Succession planning:* part of the intention of the restructure within Place is to free up the Head of Contract Management's time to focus on strategic management. This is sensible, however, given the historic experience of people with significant knowledge leaving the council, it would be sensible to ensure succession planning is in place for such a critical role. As identified above, the restructure will potentially give access to a range of middle managers with relevant experience from predecessor teams. In the short term they need to be provided with development opportunities and access to appropriate training. To ensure this is correctly addressed it is worth considering formalising this in a service wide Workforce Development Plan.

Risks

Failure to correctly resource the Highways PFI and Waste Contract management function, both in terms of staff and third party support, may result in:

- Contractors not being held to the expectations of agreements, with lower quality services provided on the Island.
- Cost deductions (as specified in agreements) not being identified and implemented, potentially leading to the Council paying for services it has not received, greater than necessary expenditure and an increased need to make savings elsewhere in the Council's budget.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;">Medium</p>	<p>The Head of Place will continue the planned restructure of Place, ensuring the following areas are addressed:</p> <ul style="list-style-type: none"> • Putting in place job descriptions which are reflective of actual responsibilities. • Cross skilling, to address the current overreliance on key members of staff, specifically regarding finance and legal expertise. • Complete putting in place call off contracts, covering technical and financial support, which is currently in progress. • Ensure appropriate succession planning is put in place for the Head of Contract management role; consider formalising this in a Service Workforce Development Plan. 	Wendy Perera, Head of Place
		<p>Target Date</p>
		November 2017
		<p>Report reference:</p>
		IOW- 01-03

4. Call Off Services (PFI) – control design

Finding

Since the 1st April 2016 up to December 2016, approximately £400,000 of extra work (above and beyond the core contract) has been commissioned from Island Roads, to comprise of approximately 30 individual pieces of work, for example additional road crossings. A further four larger projects have been commissioned, for example the new roundabout and associated road changes on St George's Way, at the termination of the link road from Staplers through the new Pan estate. None of this work has been accrued to the network.

At the time of our 2015/16 review the agreed actions were:

- To produce quantified criteria as to when it was in the Council's best interests to accrue new items to the network – when accrued, items become the responsibility of Island Roads to maintain; when not accrued, the responsibility sits with the Council.
- To produce quantified criteria as to when additional work carried out by Island Roads should be quality checked. This is linked to the bullet above, specifically if additional work is carried out by Island Roads for which the Council will be responsible for ongoing maintenance it is particularly important to ensure that it is of an adequate quality.

Neither of the actions above have been implemented. However we were informed by the Highways PFI Contracts Programme Manager that substantively all additional items are physically inspected by the two Highway Engineers in the Team and that Island Roads were challenged when work was not of an acceptable standard. This is largely managed verbally, with no records kept. The following steps now need to be taken:

- Define a quantified set of criteria to be used when quality assuring additional work carried out by Island Roads. A simple pro forma checklist would be appropriate, capturing key details about the type of work, cost, assessments made, dates of inspection etc.
- Potentially included with the checklist suggested above, an assessment of whether the best approach would be accrual to the network. At a high level this is likely to be informed by the potential scale of ongoing maintenance cost, the risk of poor quality maintenance, the scale of use (i.e. wear and tear) and location.
- Implement a system of recording. The simplest approach would be to use a spreadsheet with key metrics captured against each item of work, largely as suggested under the first bullet above. For each item, hyperlinks could be used to link through to the checklist and supporting evidence, for example e-mails converted to PDF.
- Implement a system of management reporting, potentially linked to the spreadsheet suggested directly above. At team level consideration of the spreadsheet is likely to be sufficient, summary reports should be escalated to management.

The four larger projects have been robustly managed by the former Head of Highways (prior to the PFI) and a range of e-mails have been provided to us regarding site inspections and challenge of Island Roads where they have potentially charged incorrectly – detail regarding this challenge is excluded from this report due to commercial sensitivity.

For larger projects, a significant amount of documentation is generated and a consistent filing structure does need to be agreed to ensure this is easily available if needed for future reference.

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 relevant items not being accrued to the network.

Lack of management visibility regarding the level of inspections carried out.
 Potential lack of consistency regarding the approach to carrying out inspections.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;">Medium</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"> • Define quantified criteria, potentially as a checklist, to be used when assessing additional work carried out by Island Roads. • Define quantified criteria, potentially combined with that above, to assess whether additional items of work should be accrued to the network. • Implement a system of recording jobs and assessments made, potentially as a spreadsheet, linking though to checklist and additional evidence. • Implement oversight, potentially consideration of the spreadsheet at team meeting, with summary reports produced for management. • Define a consistent filing structure to be used for larger projects. 	<p>Antony Cooke, Highways PFI Contracts Programme Manager</p>
		<p>Target Date</p>
		<p>November 2017</p>
		<p>Report reference:</p> <p>IOW- 01-04</p>





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

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

Report classifications

Findings rating	Points
Critical	40 points per finding
High	10 points per finding
Medium	3 points per finding
Low	1 point per finding

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

Appendix B: Terms of Reference

Background and Scope

The Highways PFI contract 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.

During 2015/16, arrangements for managing the client side relationship were significantly enhanced, with the creation of a new Contract Management Team, including two qualified engineers and team members with expertise in finance and law. This Team will also be responsible for managing the outsourced Waste Contract.

Alongside PFI, Waste is the highest value and longest term contract the Council has in place. We carried out two reviews of the Waste contract procurement phase and a review in 2015/16 of the initial arrangements to manage the Waste contract for the long term. None of these reviews identified major issues, specifically identifying that the Council had learned lessons from previous high value procurements and had put appropriate arrangements in place for the ongoing management of the relationship with the Waste provider.

This audit will review the enhanced arrangements to manage the client side relationship for both PFI and Waste, specifically focussing on the findings raised and actions agreed through our 2015/16 reviews. The specific control objectives and potential related risks included in this review are:

	Control objective	Potential risks
1	<p>PFI Action Plan (Response to Atkins reports)* All Atkins' reports have been reviewed and an action plan has been produced; this:</p> <ul style="list-style-type: none"> Covers the high risk issues identified by Atkins; where these are addressed by alternative mechanisms to those recommended by Atkins this has been highlighted to the Head of Contract Management. Has been approved by the Head of Contract Management. Has identified owners and due dates for all actions. Has progress overseen by team meetings, with any issues escalated to senior management. <p>We will sample test a subset of actions to confirm that progress is on track with projections.</p>	<p>If Atkins' reports have not been responded to appropriately, the value of Atkins' work will be reduced and ultimately the underlying issues they identified will remain unaddressed.</p> <p>If work is not managed formally via an action plan then ownership may be unclear, gaps may exist and actions are less likely to be completed in a timely manner.</p>
2	<p>Staffing (PFI and Waste) A combined team, to contract manage both PFI and Waste, is in place; this:</p> <ul style="list-style-type: none"> Addresses the issues identified by Atkins. Addresses the requirement to have access to specific expertise, specifically Finance and Legal, either through in-house or through arrangements with third parties. Is supported by updated job descriptions, specifically identifying responsibilities covering both PFI and Waste. 	<p>If an appropriately skilled and resourced team is not in place then it is less likely that the contract will be correctly managed, potentially resulting in a lower quality service being provided to Island residents.</p>

	Control objective	Potential risks
	Mechanisms such as cross skilling, succession planning and increased notice periods have been investigated and implemented as possible, to ensure the Council will continue to have access to appropriate skills to managed PFI and Waste.	
3	<p>Call Off Services (PFI)</p> <p>Quantified criteria have been defined covering:</p> <ul style="list-style-type: none"> • When work should be accrued to the network (i.e. added to the infrastructure maintained by Island Roads). • When additional work carried out by Island Roads should be quality checked. <p>We will sample test a subset of accruals and work carried out by Island Roads to confirm that these controls are working correctly.</p>	<p>If works are not accrued to the network, where this is the most cost effective choice, the Council will incur unnecessary additional costs.</p> <p>If the work of Island Roads is not quality checked the provider may not be held to agreed standards, the Island may receive a lower quality service and the Council may miss out on penalty payments which could be levied.</p>
4	<p>Call Handling (Waste)</p> <p>Call volumes linked to Waste calls are being monitored; specifically when spikes are expected, for example when upcoming changes are known, extra capacity is being put in place to ensure an acceptable level of service is maintained.</p>	<p>If call volumes are not being monitored and any projected increases in demand planned for then the level of service provided by the Call Centre will be degraded, potentially significantly.</p>

* Atkins are a specialist engineering company, engaged to identify solutions to issues with management of the Highways PFI.

Audit approach

Our audit approach is as follows:

- Obtain an understanding of contract management arrangements and controls through discussions with key personnel, system walkthrough and review of procedure documentation.
- Identify the key risks to these arrangements and controls.
- Evaluate the design of the controls in place to address the key risks.
- Test the operating effectiveness of the key controls.

Appendix C: Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken the follow up review of Highways PFI and Waste contract management arrangements 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 and Waste contracts is for controls effective from 1st April 2016 to 1st 30th November 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.

Isle of Wight Council

Internal Audit Report 2016/17

Pan Meadows

September 2017

FINAL



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Distribution List

For action	Wendy Perera, Head of Place Bill Murphy, Head of Contract Management Rod Warne, Insurance Manager
For information	Elizabeth Goodwin, Chief Internal Auditor

3. Executive summary

<p>Report classification</p>  <p>High Risk</p>	<p>Trend</p>  <p>We have not previously reviewed the Pan Meadows Development</p>	Total number of findings					
			Critical	High	Medium	Low	Advisory
		Control design	0	1	3	1	0
		Operating effectiveness	0	0	0	0	0
		Total	0	1	3	1	0

Summary of findings:

The Pan Meadows initiative is an agreement between three stakeholders, the Council, Sovereign Housing Group (signed by Weston Challenge Housing Association, a predecessor organisation) and Barratt Homes, the agreement being sealed by the Council on the 3rd March 2010, subsequent to being signed by the three parties to the agreement.

The signed agreement sets out a range of benefits for the Island, at a high level increasing the number of houses available, both for purchase and as social housing and associated employment and training opportunities for Island residents. For clarity, beyond the need to ensure that 30% of the developments is social housing, necessary to satisfy the requirements of a grant from the Homes and Communities Agency, there are no penalties identified in the agreement for non-delivery of projected activities, for example employment, training opportunities and reporting, while we were informed that build rates were considered estimates from the start of the agreement.

The process of transferring land from the Council to Barratt Homes is well defined, dependent solely on the completion of units in each 'tranche'. Subsequent to the initial payment of £1,000,000 from Barratt Homes, further payments are scheduled to be made as each phase of the development is completed. To date no further payments have been made as, although elements of phase two have been completed, elements of phase one are still outstanding.

Beyond management of the land transfer process, the Council's sole ongoing involvement in the initiative is as a member of the Pan Management Company, with the Head of Contract Management sitting on the Board.

This review was scheduled to ensure that appropriate arrangements are in place at the Council to correctly manage the Pan Meadows development. Our fieldwork was structured as below:

- *Framework Agreement*: ensuring that a signed agreement is in place, covering areas such as roles and responsibilities, performance metrics, change management and oversight arrangements.
- *Oversight/Governance*: ensuring that an appropriate forum is providing ongoing oversight, with terms of reference and formally managed meetings, with agendas and minutes produced.
- *Delivery/Change*: ensuring that change and land transfers have been correctly managed, roles and responsibilities are being satisfied and appropriate performance management is in place.

We were provided with a copy of the original agreement signed by the Council, Weston Challenge Housing Association and Barratt Homes; this covers key areas, specifically roles, responsibilities, performance targets, oversight arrangements and the process of transferring land to the developer. We also note that included alongside the original agreement are four agreed contract variations, for example regarding; changes to the agreed start date for the development, linked to a delay in granting initial planning permission; and adjustments to phase completion payments, linked to a higher than anticipated infrastructure cost in phase one (these are currently being validated by third party financial advisors to the Council under the open book accounts approach specified in the original agreement).

Up to Year Three (2012/13) of the Pan Development, the Council had a dedicated Project Manager in place. While minimal documentation is available from this period we were informed that regular meetings were held between the Project Manager and the developer and we have been provided with some performance reporting up to 2012/13.

Following the departure of the then Pan Project Manager in mid 2012, we were informed that responsibility for ongoing management of the Pan Development from the Council's perspective was transferred to another senior officer, who left the Council's employment in March 2015; no records are available from this period.

Since taking on responsibility for the Pan Development from Summer 2015 (effectively responsibility between March 2015 and Summer 2015 sat with the Managing Director) the current Head of Contract Management has made considerable progress in normalising the position. Most importantly the Pan Management Company (ManCo) is now correctly constituted, with representatives from the Developer, Sovereign Housing and the Council and a contract to support the ManCo is in place with a professional property management company. We also noted that the proportion of social housing, required by the Homes and Communities Agency grant (30%), has been achieved and our sample testing (two out of four tranches signed over since the 1st April 2016) confirms that the process of transferring land to the developer is being correctly managed, with appropriate evidence being retained. Regarding build rates (i.e. the number of housing units built within a period of time) and wider performance targets, while both are identified in the original agreement, no penalties for non-achievement are identified for either and we were informed by the Head of Contract Management that build rates were always considered indicative by all parties from the outset.

While there are still issues to resolve, the current position is a considerable improvement over that in place historically and the Council is confident that there are grounds for optimism that remaining issues will be addressed over the next six to 12 months. We have grouped our fieldwork as five detailed findings, summarised below:

Succession Planning, Record Keeping and Lessons Learned: the lack of formality regarding record keeping and staff succession planning are at the root of most of the issues which are either current or historic in relation to the Pan Development. Minimal record keeping and a failure to implement adequate hand over procedures when staff responsible for Pan have left the Authority have led to a loss of organisational memory, with each new senior member of staff assigned responsibility for Pan effectively having to start from scratch. Specifically, prior to 2016, apart from in association with land transfers, minimal documentation is available regarding the Pan Development, beyond the original signed agreement. We also noted that no penalty clauses are specified for the non-achievement of performance indicators (covered in more detail further below). While of limited relevance to the Pan agreement, given the time that has elapsed since the agreement was signed, the Council should endeavour to ensure these are included in any future agreements of this type.

While good progress is being made addressing the specific issues with Pan, these underlying causes would benefit from being addressed to improve the management and record keeping in regard to future agreements the Council makes. Specifically identifying the agreements the Council has in place, documenting and applying hand over processes when the senior personnel responsible changes and putting in place a suitable electronic file storage system for all key documentation, for example meeting minutes. We have raised this as a **high risk** finding.

Pan Management Company (ManCo): while documentation provided for our review does not identify any explicit expectation that the Council would 'step in', should the ManCo fail and the Council's nominated director's liability is limited to £1, this has to be viewed in the context of the poor record keeping associated with the Pan development historically. There have been a number of problems with the Heat/Water Plant on the Pan Development, including: failures of infrastructure leading to a loss of heat/power to residents; a high level of loss in the heating infrastructure between the plant and residents' homes; a high level of unpaid bills from residents leading to an outstanding debt to Sovereign Housing; and a failure to fully recoup the costs of gas (an interim gas powered solution is currently in place), potentially impacting on the financial viability of the ManCo.

Potentially, if the contract had been more robustly managed, and specifically if all stakeholders had engaged fully in the ManCo, in the early years this issue may have been identified, escalated and addressed in a timelier manner. At a high level the Council needs to ensure that there is an agreed, binding agreement in place clearly setting out what, if any, responsibilities the Council has in the event that the ManCo should fail. At a more detailed level the Council, through its director, needs to use its best efforts to ensure that outstanding debts are pursued robustly, a repayment plan put in place to repay the debt to Sovereign Housing and charges to residents are increased to a level where the cost of providing heat/water is fully recouped. We have raised this area as a **medium risk** finding. We were informed by the Head of Contract management that, subsequent to the completion of our fieldwork, the Board has resolved to increase the charges to residents to a level where cost are fully recouped.

Performance Management/Reporting: Employment and Skills: the original agreement sets out a range of targets regarding training and employment opportunities to be provided to Island residents associated with the Pan development, for example the number of apprentices to be recruited each year. A number of these targets have been modified, either the metric and/or the target, from that set out in the original agreement. While the changes appear sensible, for example due to delays in starting work in Year

One, we did note that no change documentation is available from the period when they were made, during the first three years of the agreement. The last reporting provided to the Council was in Year Three of the agreement (2012/13), with associated documentation identifying that the developer had concerns at the time that the targets identified were unachievable, due to a number of issues, for example high dropout rates (greater than 28%) amongst apprentices recruited.

This position needs to be normalised. The first step should be to request up to date information regarding the current initiatives the developer has in place and the actual performance. Following on from this a recovery plan needs to be agreed, to ensure that Island residents are receiving appropriate benefits regarding training and employment, broadly in line with the intentions of the original agreement. We have raised this area as a **medium risk** finding.

Performance Management/Reporting: Environmental Targets: the original agreement identifies documentation which should be provided by the developer to the Council regarding its sustainability plans, for example how the developer will aim to reduce waste to 10 tonnes per £100,000 of construction value. The developer is also required to provide an annual report to the Council, identifying the tonnes of waste generated per £100,000 of construction value and tonnes of waste to landfill per £100,000 of construction value.

While potentially these documents were provided to the Council in the early years of the agreement (up to Year Three, when there was a specific Pan Project Manager in post) our enquiries have been unsuccessful in locating any applicable documentation.

This situation needs to be rectified. The first step needs to be to request up to date reporting from the developer, with targets refined as necessary and a realistic reporting regime put in place for the remainder of the agreement term. We have raised this as a **medium risk** finding.

A further result of the lack of performance reporting identified in the two findings above was that we were unable to test a sample of key performance metrics against evidence, to confirm that contractual requirements are being complied with. Once the issues have been resolved, further consideration should be undertaken by the Council as to how they can be assured that performance reporting is accurate.

Stakeholder Responsibilities: the overarching responsibility on all of the stakeholders (the Council, Barratts and Sovereign Housing) is to support and participate in the ManCo. While this requirement has not been satisfied historically, since summer 2015 all of the stakeholders have appropriate director representation on the ManCo and our review of recent ManCo minutes confirm this forum is working correctly. More widely, key responsibilities have been largely satisfied, for example completion of 30% social housing by the 30th September 2014 target completion date, to meet the requirements of the Homes and Communities Agency grant.

However our review did identify two areas which should be revisited to ensure that appropriate arrangements are in place: insurance, both by the developer and ManCo and that every effort is made to market units to individuals, prior to marketing to private landlords. We have raised this area as a **low risk** finding.

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

Management Response

The outcome of the audit is noted and it is acknowledged that the audit area considered to be high risk relates specifically to the difficulties that have arisen due to succession planning, record keeping and lessons learned. It is accepted that this had resulted in the loss of “organisational memory” and accepts that for a project of this size measures should be taken to improve on this.

However in considering the report as a whole it should be noted that the Pan Management Company is now correctly constituted and that it has now employed a professional management company. The position remains as set out in the summary that the council is confident that issues can be resolved during the next 6 to 12 months or so. However the report also refers to the successful early delivery of the social housing which was one of the drivers for the development. It also cannot be overstated that due to the physical configuration of the development including extensive levels changes, the provision of a spine road link that transects the development, the provision of a district heating system and that development rates now rely on the private sector that some of the original intent and metrics within the Development Agreement are probably now out of date.

4. Detailed current year findings

1. Succession Planning, Record Keeping and Lessons Learned – control design

Finding

The lack of formality regarding record keeping and staff succession planning are at the root of most the issues which are either current or historic in relation to the Pan Development. While in recent months this has improved, minimal record keeping and a failure to implement adequate hand over procedures when staff responsible for Pan have left the Authority have led to a loss of organisational memory. This has meant that each new senior member of staff assigned responsibility for Pan effectively having to start from scratch.

As covered elsewhere in this report, significant progress has been made in the last 12 months. However this root issue still needs to be addressed, and is equally applicable across the Council's management of agreements, not just to the Pan Development.

Specific to the Pan Development, apart from the original agreement, some performance reporting up 2012/13 and documentation regarding the transfer of land to the developer up to the time of our fieldwork, there are minimal records available, for example agendas and minutes of meetings held between Barratt Homes and the Council. Furthermore, all of the senior Council staff historically involved in managing the agreement have now left the Council. We also note that while there are performance indicators specified (covered in more detail in subsequent findings) there are no penalty clauses specified in the agreement. While it is unlikely to be possible to add these into the Pan agreement this is something which should be considered for any future agreements of this type.

The wider lessons the Council needs to learn from Pan, applicable across all arrangements with external parties, are:

- A suitable handover process needs to be put in place when senior staff responsible either leave the Council or change role – ideally this should include a period of 'parallel running', with joint responsibility. To minimise future impact of staff leaving the Council, succession planning regarding external agreements should be put in place.
- Responsibilities and key processes need to be documented – in the event that handover is not well managed this would provide a starting point for senior staff taking on responsibility for agreements, to ensure that processes continue to function without interruption.
- An appropriate filing structure needs to be put in place for external agreements, with documentation stored electronically rather than in paper form.

Risks

Loss of corporate memory and continuity resulting in the failure to realise benefits from agreements with external parties and a failure to hold external parties to the terms of agreements. In the event of challenge or disagreement with external parties the Council cannot refer back to past decisions and / or actions agreed. This could leave the council vulnerable to financial and / or performance loss.

If penalty clauses are not included in agreements it may be difficult to enforce an agreed level of performance, potentially adversely impacted on the achievement of projected benefits.

Finding rating	Agreed actions	Responsible person / title
High	<p>The Head of Contract Management will agree actions with senior colleagues for implementing better processes for succession planning and improved record keeping regarding agreements with external parties covering:</p> <ul style="list-style-type: none"> • Identification of external party agreements and an agreed, documented hand over process for agreements. • Documenting of key processes/mechanisms for each agreement. • An appropriate filing structure to be used for documentation associated with agreements. • The inclusion of penalty clauses for non-achievement of performance indicators. 	Bill Murphy, Head of Contract Management
		Target Date
		November 2017
		Report reference:
IOW- 08-01		

2. Pan Management Company (ManCo) – control design

Finding

The Pan Management Company (ManCo) is set up as a Community Interest Company (CiC). Currently there are four directors, two nominated by Barratts and one each by the Council and Sovereign Housing Group. Decisions at meetings are by a simple majority (quorum is set at two directors), or out of meetings decisions must be unanimous. At a high level the responsibility of the ManCo is to 'manage' the estate, for example open spaces and most importantly the Heat/Water Plant. The documentation we have been provided with identifies that directors' liabilities (as members) is limited to £1, we have not identified any financial liability which could fall to the Council should the ManCo 'fail'.

From our review of recent minutes of meetings of the ManCo the main issues which need to be resolved are in relation to the Heat and Water plant, which provides these services communally to all residents of the Pan Development. While this is peripheral to the scope of our review, it was one of the key benefits associated with the development, aiming to provide reduced cost heat and power from a sustainable source (wood chip) – if the contract had been more robustly managed in the early years this issue may have been identified, escalated and addressed in a more timely manner.

The Plant has suffered from a number of problems, both for residents and potentially the sustainability of the ManCo, specifically:

- Failures in the infrastructure, leading to a loss of heat/water to residents, who have therefore incurred additional electricity costs.
- A high level of loss in the infrastructure between the plant and residents' homes; this is identified in the 16th June 2016 ManCo minutes as five million kWh hours, out of eight million kWh hours of gas consumed being 'lost' in system.
- A high level of unpaid bills from residents for heat/water; this is identified in the 6th September 2016 ManCo minutes as £75,690.03. This has led to a debt to Sovereign Housing of £20,000 which the ManCo is not able to meet from its currently available funds.
- Poor performance by the company responsible for management of the interim gas solution; currently subject to ongoing discussion.

We were informed by the Head of Contract Management that, subsequent to the completion of our fieldwork, the issue regarding unpaid debt to Sovereign Housing has been resolved.

While our review has not identified any explicit expectation that the Council would have to step in should the ManCo fail, this has to be viewed in the context of the lack of formality regarding record keeping and staff succession planning regarding the Pan development, as covered in finding one above.

At a high level, as a precaution, the Council needs to confirm exactly what their responsibilities would be should the ManCo fail and ensure that there is a signed agreement in place clearly specifying what, if any, liabilities may exist. We also note that Barratts currently has an inbuilt majority in the ManCo's decision making structure. The articles for association identify that there can be up to six directors. If the Council is able to gain agreement from the other directors, increasing the number of directors, to remove this inbuilt majority, is worth considering.

At a more detailed level identifying the best long term solution for Pan and the ManCo is beyond the scope of this report. However in the short term action needs to be taken to put the ManCo on a sound financial footing; specifically:

- Robustly pursuing outstanding debts from residents as planned, including efforts to trace ex-residents with outstanding bills.
- Putting in place a repayment plan for the outstanding debt owed to Sovereign Housing.
- Increasing charges to residents, to a level where the charges fully recoup both the costs of gas and operational cost of the Heat/Water Plant.

Subsequent to the completion of our fieldwork we were informed by the Head of Contract Management that the first and last bullet points directly above have now been addressed.

While the Council only holds one of the director post it should use its best efforts to ensure that the issues set out directly above are addressed as soon as possible.

Risks

Potential financial liabilities to the Council, should the ManCo fail.
 Failure to put the ManCo on a sustainable long term financial position, impacting on services provided to the residents and potentially causing reputational damage to the Council.
 Failure to provide reliable, sustainable and cost effective heat and hot water to residents.

Finding rating	Agreed actions	Responsible person / title
Medium	The Council Head of Legal Services, supported by the Head of Contract Management, will:	Bill Murphy, Head of Contract Management
	<ul style="list-style-type: none"> • Ensure that there is an agreed, binding agreement in place, clearly identifying what, if any, financial obligations would fall to the Council should the ManCo fail. • If possible increase the number of directors, to remove the inbuilt majority currently held by Barratts. 	Target Date
		November 2017
	The Head of Contract Management will use his best efforts to ensure the ManCo: <ul style="list-style-type: none"> • Puts in place a repayment plan for the outstanding debt owed to Sovereign Housing. • 	Report reference:
	IOW- 08-02	

3. Performance Management/Reporting: Employment and Skills – control design

Finding

Targets are identified for each year of the original agreement, running up to 2023/24 (Year 13). Below we have extracted the targets applicable up to the current year (2016/17) and the overall targets, up to Year 13 of the agreement.

	Year 1 10/11	Year 2 11/12	Year 3 12/13	Year 4 13/14	Year 5 15/16	Year 6 16/17	Total (over 13 years)
School/university/college site visits	7	8	8	7	8	8	78
School workshops no	4	4	4	3	4	4	39
Research projects	1	1	1	1	1	1	13
Trainee 14 - 16 (person weeks)	6	9	9	8	7	7	76
Trainee 16+ (person weeks)	54	72	72	62	60	60	632
Apprentices - (person weeks)	180	250	250	217	200	200	2137
Project initiated Apprentices - No of starts	8	10	10	9	8	8	94
H&S tests	90	105	105	91	100	100	1011
NVQs	32	45	45	39	35	35	378
CSCS no	63	90	90	78	70	70	755
Short courses	8	9	9	8	9	9	90
Employment opps - No of starts	8	9	9	8	9	9	90

The last report provided to the Council was in Year Three of the agreement, 2012/13. The performance indicators reported are broadly in line with those in the original agreement, however there have been a number of changes, both to the expected level of performance and the performance indicator set report, for example:

- Site visits, number of children; a new performance indicator, introduced in Year One.
- School/college/university site visits; target reduced to four, from seven, in Year One.
- Reporting for apprenticeships broken down by trade (for example electrical, plumbing, carpentry etc.) from Year One.

These changes date from the time that the Council had a full time Project Manager for Pan in place. While no documentation is available from this period the changes appear reasonable. For example the reduction in some Year One targets is likely to be linked to delays in the granting of planning permission, delaying the start of construction on the site.

In the 2012/13 reporting provided to the Council the developer identified concerns that they would be unable to meet the overall targets due to a number of issues, summarised below:

- Apprentice dropout rates in excess of 28%.
- Poor work ethic with Island employees.
- A lack of sufficient skills amongst the Island workforce.
- Problems regarding the certification scheme used by the Isle of Wight College not aligning with the developer's needs.

The developer also suggests a number of actions which could be taken to address these issues, for example targeting older age groups for training and engaging with wider organisations focussed on promoting employment opportunities.

The 2012/13 reporting also identifies that while a number of targets were either met or partially met over the first three years of the agreement, for example school visits and university linked research, many of the targets, specifically those associated with promoting Island based employment have not been met. We also noted that no reports have been provided by the developer to the Council against the Employment and Skills targets for the last three years – for context, no penalties are identified in the agreement for failing to comply with these performance indicators.

While this is undoubtedly linked both to the issues summarised in the bulleted list above and lack of capacity at the Council prior to 2016/17, to manage the agreement the current situation does need to be normalised. The first step needs to be requesting information from the developer regarding the current initiatives they have in place and their actual performance. Following on from this, a recovery plan needs to be agreed, to ensure that Island residents are receiving appropriate benefits regarding training and employment, broadly in line with the intentions of the original agreement, specifically:

- Agreeing a realistic set of performance indicators and targets, covering skills, training and employment.
- Putting in place a realistic performance reporting regime. For example this could be a standing item for discussion at ManCo meetings, including highlighting any issues, with a summary report produced quarterly or annually.

An alternative approach worth considering would be for the developer to agree to pay external parties to provide programmes of training and employment opportunities for Island residents, broadly in line with that originally envisaged although potentially not directly provided on the Pan site. This should be considered and discussed with the developer as a potential option to normalise the current position.

Risks

If the developer is not held to honour and report its performance against the original agreement then:

- The Island and its residents will not benefit to the degree set out in the agreement from the Pan development.
- The Council will not have an accurate view of the benefits which have been realised to date from the Pan development.
- The credibility of the Council will be impacted if they are seen as not enforcing agreements of this type.

Finding rating	Agreed actions	Responsible person / title
Medium	<p>The Head of Contract Management will:</p> <p>Agree timescales to review performance management/reporting arrangements, in collaboration with the development agreement partners, both Barratts and Sovereign.</p>	Bill Murphy, Head of Contract Management
		Target Date
		November 2017
		Report reference:
		IOW- 08-03

4. Performance Management/Reporting: Environmental Targets – control design

Finding		
<p>The key environmental targets and reporting expectations set out in the original agreement are set out below:</p> <ul style="list-style-type: none"> • An annual report covering tonnes of waste generated per £100,000 of construction value and tonnes of waste to landfill per £100,000 of construction value. • Developer to provide evidence of how they will: <ul style="list-style-type: none"> ○ Reduce waste to a maximum of 13 tonnes per £100,000 of construction value, and aim to generate less than 10 tonnes per £100,000 construction value. ○ Recover a minimum of 70% of construction materials, and aim to exceed 80%. ○ Recover a minimum of 80% of demolition, strip-out and excavation materials, and aim to exceed 90%. ○ Ensure that at least 10% of total material value derives from reused and recycled content in new build, and select and implement the top opportunities to exceed this figure without increasing the cost of materials. <p>While potentially reports were provided to the Council in the early years of the agreement (up to Year Three, when there was a specific Pan Project Manager in post) our enquires have been unsuccessful in locating any applicable documentation – for context no penalties are identified in the agreement for failing to comply with these performance indicators.</p> <p>The current situation needs to be normalised. The first step needs to be to request up to date reporting from the developer, covering the areas above. Following on from this, the performance measures and targets need to be confirmed as still applicable and realistic; as necessary performance measures and targets then need to be refined accordingly. Once an agreed set of performance measures and targets is in place an appropriate reporting regime needs to be agreed, broadly in line with the expectations of the original agreement.</p>		
Risks		
<p>Failure to meet environmental sustainability targets associated with the Pan Development, leading to a wider adverse impact on the Island’s environment. More widely, if these requirements are not enforced and evidenced, then the credibility of both this agreement and future agreements of this type will be impacted.</p>		
Finding rating	Agreed actions	Responsible person / title
Medium	<p>The Head of Contract Management will:</p> <p>Agree timescales to review performance management/reporting arrangements, in collaboration with the development agreement partners, both Barratts and Sovereign.</p>	Bill Murphy, Head of Contract Management
		Target Date
		November 2017
		Report reference:
		IOW- 08-04

5. Stakeholder Responsibilities – control design

Finding

While there is not a specific section regarding the responsibilities of the three stakeholders (the Council, Barratts and Sovereign Housing) these are identified at various points in the original agreement.

The overarching responsibility, applicable to all of the stakeholders, is to participate in the ManCo, in line with its terms of reference. This has not been complied with historically, reaching a point in March/April 2015 when there was only one director of the ManCo in place, from Sovereign Housing and the accounts were filed late. Significant progress has now been made since the Head of Contract Management took on the Council's responsibility for Pan in Summer 2015. The ManCo is now supported by a professional property management company, with directors in place from all stakeholders as set out in the ManCo's terms of reference. We were also provided with the minutes for the last three meetings of the ManCo and while there are ongoing issues (covered in finding two above), it is functioning effectively.

Regarding wider responsibilities these have largely been satisfied. For example we were informed by the Head of Contract Management that the required 30% of social housing was achieved by the 'target completion date', identified as the 30th September 2014 in the original agreement – this was primarily the responsibility of Western Challenge (now Sovereign Housing) and was required to satisfy the requirements of a Homes and Communities Agency grant of £11,107,500 to fund the development of social housing.

Performance metrics for Barratts to meet are specified in the agreement and, while they are covered in separate findings above and would benefit from being revisited, it is important to note no penalties for noncompliance are identified in the agreement. We have identified two responsibilities which sit with Barratts which, while not major, would benefit from being normalised:

- *Section 8.1 Insurance*: the Council should request sight of Barratts' insurance documents to ensure they are adequate; it would be sensible for the Council's Insurance Manager to take responsibility for this action. Associated with this the ManCo is responsible for all 'public' land on the development. While peripheral to the scope of this review it would also be sensible for the Council's Insurance Manager to review the insurance the ManCo has in place, to confirm this is adequate.
- *Section 12 b Not Selling Units to more than one purchaser (excluding Sovereign Housing)*: the wording of this clause is open to interpretation. However at a minimum Barratts should be notifying the Council where multiple units have been sold to a single purchaser and providing evidence that they have made every effort to market them individually. While this might not be realistic for historic sales the requirement should be reiterated and requested for all future sales.

Risks

Failure of Barratts to have adequate insurance in place, potentially leading to uninsured claims which are not sufficiently covered, which could lead to reputational damage for the wider Pan development.

Failure to maximise sales of units on Pan to individuals and benefits to Island residents, through unnecessary block sales to private landlords.

Finding rating	Agreed actions	Responsible person / title
Low	The Insurance Manager will: <ul style="list-style-type: none"> • Request and review the insurance Barratts has in place to ensure that it is adequate. 	Rod Warne, Insurance Manager Bill Murphy, Head of Contract Management
	The Head of Contract Management will:	Target Date
	<ul style="list-style-type: none"> • Reiterate the requirement to evidence that every effort has been made to market units to individuals, prior to sales to private landlords, requiring this for all future sales. 	November 2017
		Report reference:
		IOW- 08-05





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

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

Report classifications

Findings rating	Points
Critical	40 points per finding
High	10 points per finding
Medium	3 points per finding
Low	1 point per finding

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

Appendix B: Terms of Reference

Background and Scope

The Pan Meadows development has been running for six years and is the major initiative on the Island to increase the number of social housing units available for rent.

The Project is a partnership between the Council, Sovereign Housing Group (signed by Weston Challenge Housing Association, a predecessor organisation) and Barratt Homes and includes a number of innovative elements, for example, combined heat and power from renewable sources to provide green energy to the development.

A core component of managing the site, including the combined power element, is the Management Company, a joint initiative between residents, the Council, Spectrum Housing Group and Barratt Homes.

This audit will review the Management Company, focusing on the expectations documented in the original agreement, to ensure that these are being complied with.

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

	Control objective	Potential risks
1	<p>Framework Agreement Expectations regarding the Pan Meadows development, including the Management Company, are clearly specified in agreement(s) signed by the three stakeholders (the Council, Spectrum Housing Group and Barratt Homes); including:</p> <ul style="list-style-type: none"> • The roles and responsibilities of each stakeholder. • Quantified performance metrics, which each stakeholder is expected to meet, including penalties for non-achievement. • Any payments/asset transfers to be made and how these are linked to the achievement of performance metrics. • Reporting arrangements. • Oversight arrangements, for example forums, meeting, reporting and escalation mechanisms. • How change will be managed. 	<p>If roles, responsibilities and accountabilities are not clearly specified in binding agreements then these may be unclear, gaps are more likely to exist and ultimately the Pan development is less likely to deliver its projected benefits in a timely manner.</p> <p>If an appropriate framework, including reporting, is not in place then there is likely to be insufficient oversight and issues may not be identified and addressed at the earliest opportunity.</p> <p>Without effective oversight inaccurate payments will be more likely to be made.</p>
2	<p>Oversight/Governance Oversight/Governance is in line with the expectations of the original agreement(s):</p> <ul style="list-style-type: none"> • Performance reporting is being produced and shared between stakeholders. • Oversight forum(s) have: <ul style="list-style-type: none"> • Agreed terms of reference. • Appropriate membership and attendance. 	<p>If effective oversight is not in place then underperformance will be less likely to be identified and addressed at the earliest opportunity; ultimately the Pan development is less likely to deliver its projected benefits in a timely manner.</p> <p>If governance/forum protocols are insufficient then the development and management company are less likely to be effectively run, ultimately the Pan development is less likely to deliver its projected benefits in a timely manner.</p>

	Control objective	Potential risks
	<ul style="list-style-type: none"> • Are meeting at regular intervals, with documented agendas and minutes. Receive and act on performance reporting, escalating as necessary.	
3	<p>Delivery/Change</p> <p>The terms of the original agreement(s) are being complied with:</p> <ul style="list-style-type: none"> • Work is proceeding in line with the agreed schedule. • Performance linked to payments is appropriately evidenced. • Roles and responsibilities are being exercised correctly by stakeholders. <p>Any changes to the original agreement have been managed in line with original agreement(s)/good practice, with any linked expectations updated as necessary.</p>	<p>If agreement(s) are not being complied with then the effectiveness of the framework will be adversely impacted, ultimately the Pan development is less likely to deliver its projected benefits in a timely manner.</p> <p>If change is not correctly managed then inappropriate changes may take place informally, the integrity of the framework will be adversely impacted, ultimately the Pan development is less likely to deliver its projected benefits in a timely manner.</p>

Audit approach

Our audit approach is as follows:

- Obtain an understanding of how the Pan Meadows Development is managed, through discussions with key personnel and review of key documentation.
- Identify the key risks to the management arrangements over the Pan Meadows development. Assess the design and operation of controls in place to mitigate these key risks.
- Test a sample of key performance metrics against evidence, to confirm that contractual requirements are being complied with.

Appendix C: Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken the review of the Pan Meadows development 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 Pan Meadows development is for controls effective from April 2016 to December 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.

Isle of Wight Council

Internal Audit Report 2016/17

Payment Card Industry, Data Security Standard
(PCI DSS)

April 2017

FINAL

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Distribution List

For action	Gavin Muncaster, Strategic Manager ICT & Digital Services Dean Finlayson, Technical Support Lead Cate Sheen, Contact Centre Manager Lawrence Edmonston, Leisure Facilities Manager
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For information	Elizabeth Goodwin, Interim Head of Internal Audit
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5. Executive summary

Report classification  High Risk	Trend  A worsening of the risk associated with PCI DSS since our last review in 2014/15.	Total number of findings					
			Critical	High	Medium	Low	Advisory
		Control design	0	1	3	0	0
		Operating effectiveness	0	0	0	0	0
		Total	0	1	3	0	0

Summary of findings:

The Payment Card Industry, Data Security Standard (PCI DSS) is the standard which all organisations taking card payments are required to comply with, to ensure that cardholder data is adequately safeguarded. Compliance is evidenced primarily through completion of an annual Self-Assessment Questionnaire (SAQ), which sets out a number of assertions regarding required controls that organisations have in place, for example external network penetration testing and the use of up to date antivirus software.

This review was scheduled to ensure that the Council has taken appropriate steps to comply with PCI DSS expectations and to review the steps the Council is taking to maintain compliance with the introduction of version 3.0 of the PCI DSS standard.

This review was structured as below:

- *Core Technical Requirements:* confirming that the Council holds a passing SAQ, with appropriate mechanisms in place to support key technical assertions, for example satisfactory conclusions from penetration testing and having appropriate anti-virus software in place.
- *Core Non-Technical Requirements:* confirming that the Council has appropriate mechanisms in place to support key non-technical assertions in its SAQ, for example mechanisms to ensure cardholder details are not inadvertently captured.
- *PCI DSS Version 3.0 Changes:* confirming that the Council has reviewed new/changed requirements stemming from PCI DSS 3.0, for example enhanced event logging and mechanisms to periodically check Point of Sale Machines (PoS), for key logging devices and has plans in place to introduce enhanced arrangements as necessary.

Regarding the Council's current position we were provided with a passing certificate from the most recent external penetration test of the Council's network, valid up to the 11th March 2017. However a copy of the certificate evidencing PCI DSS compliance (normally issued following submission of an acceptable SAQ) could not be located, although the Strategic Manager ICT & Digital Services informs us that the Council has been certified as compliant up to February 2017.

While the Council is confident that it is currently compliant, it is in the process of redesigning its online card payment webpages, moving the entry of card details from webpages hosted on Council equipment, to webpages hosted by its payment processor. While the impact of this change on the controls needed to meet PCI DSS expectations needs to be confirmed with the Council's payment processor, it does have the potential to reduce the Council infrastructure deemed 'in scope' from a PCI DSS perspective and consequently reduce overhead associated with maintaining ongoing compliance.

However it is likely that there will be a gap in the Council's PCI DSS compliance, until the redesigned webpages go live, confirmation is received from the Council's payment processor as to the impact on the applicable PCI DSS requirements and a new SAQ can be submitted and accepted. Additionally, while the Council has been informed verbally that they will be able to continue taking card payments during this period, subject to a monthly surcharge of £10, we were informed that this has not been confirmed by the payment processor in writing. Due to the lack of a passing SAQ and uncertainty regarding the Council's current PCI DSS status we have rated the relevant finding below, regarding the current SAQ status and this area overall as **high risk**.

We have raised four detailed findings, summarised below:

Self-Assessment Questionnaire (SAQ): As noted above, we were unable to source a current, passing PCI DSS certificate. We were informed by the Strategic Manager ICT & Digital Services that the Council is certified as compliant up to February 2017. A copy should be re-requested and, for future copies of the SAQ, secure storage ensured. As the SAQ certifies PCI DSS compliance lodging a copy with Legal Services should also be considered. We have raised this area as a **high risk** finding.

Core Requirements: A passing penetration test (confirming that the perimeter and in-scope infrastructure is adequately secured, by a PCI DSS certified security assessor) was provided for our review, valid up to the 11th March 2017. While data flow diagrams exist (identifying all infrastructure through which card details pass, which is therefore 'in scope' from a PCI DSS perspective) a formal register of infrastructure items is not currently maintained. A formal register should be implemented, including key metrics such as ownership and specific

PCI DSS compliance expectation, for example checking PoS machines for the presence of key loggers (unauthorised devices, added to PoS machines to capture PINs when they are entered). We also noted that vendor documentation for wireless PoS machines provided for our review identifies PCI DSS 3.0 compliance as 'optional'; the presence of this functionality should be confirmed with the device vendor. We have raised this area as a **medium risk** finding.

Responsibilities and Training: a variety of activities are required to maintain ongoing PCI DSS compliance and, at a high level, responsibility is implicitly understood, for example the IT Compliance & Infrastructure Manager is responsible for ensuring that an appropriate programme of external penetration tests are carried out. However it would be helpful for all activities to be compiled into a single document, identifying individual and overall responsibility, ensuring all activities are satisfactorily carried out. This would also help to confirm that they are carried out consistently and that no gaps exist. Furthermore, wider senior management should be consulted with over whether the Strategic Manager ICT & Digital Services is the best officer to take overall responsibility for ensuring PCI DSS compliance. This responsibility may better sit with a non-technical area of the Council, for example corporate finance.

At a more granular level, the primary area within the Council where card payments are processed is in the Contact Centre. We noted that staff are prohibited from taking mobile phones into the Contact Centre, minimising the opportunity for card numbers to be inappropriately captured. However PCI DSS related requirements, for example the need to ensure that card numbers are not inadvertently captured, are not currently explicitly covered. More widely, as identified on the action plan of planned PCI DSS enhancements, a more formalised approach needs to be taken regarding providing and recording completion of PCI DSS related training. This needs to include all staff taking card payments, for example those using PoS machines in leisure centres, in addition to those in the Contact Centre. We have raised this area as a **medium risk** finding.

PCI DSS Version 3.0 Changes: the Council has reviewed the new/changed requirements introduced by PCI DSS Version 3.0 and produced an initial action plan detailing the work necessary to ensure compliance; for context version 3.0 is effective from April 2016, however we were informed by the Council that the SAQ, which is still current, was submitted under the previous version of the standard. This identifies 20 actions, for example enhancing technical controls and mechanisms to maintain security, for example checking PoS machines for the presence of key loggers. We initially sample tested five actions, confirming that appropriate mechanisms were in place for two actions, regarding enhanced logging and securing unused network points. For three actions it did not prove possible to source evidence regarding their implementation, or progress towards implementation.

Further discussion with the Strategic Manager ICT & Digital Services identified that the action plan provided for our review was an initial gap analysis only, with only limited work carried out to date to address actions. As identified above the Council is in the process of changing the way it captures card details, which has the potential to reduce the overhead of maintaining PCI DSS compliance. Once the impact of this change has been confirmed with the Council's payment processor, the action plan needs to be refined accordingly, relevant sections of the SAQ completed and progress regarding the action plan robustly managed. 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.

6. Detailed current year findings

5. Self-Assessment Questionnaire (SAQ) – control design

Finding		
<p>We were informed by the Strategic Manager ICT & Digital Services that a passing Self-Assessment Questionnaire (SAQ) is in place, certifying the Council's PCI DSS compliance up to February 2017. However it has not proved possible to locate a copy - a replacement has been requested from WorldPay, the Council's payment processor, but has not yet been provided; this should be re-requested.</p> <p>For future copies of SAQs and associated documentation, copies should be stored securely. As this document certifies compliance with PCI DSS it may be appropriate for a copy to be lodged with Legal Services in future, this should be investigated.</p>		
Risks		
<p>Failure to retain adequate records regarding PCI DSS compliance may lead to the Council having difficulty evidencing ongoing compliance and/or necessary activity, for example resubmission of the SAQ, may not happen in a timely manner.</p>		
Finding rating	Agreed actions	Responsible person / title
High	<p>The Strategic Manager ICT & Digital Services will:</p> <ul style="list-style-type: none"> • Re-request a copy of the passing SAQ form Worldpay. • Ensure that in future the SAQ is stored securely, with potentially a copy being held by Legal Services. 	Gavin Muncaster, Strategic Manager ICT & Digital Services
		Target Date
		February 2017
		Report reference:
		IOW- 06-01

6. Core Requirements – control design

Finding

A passing penetration test (confirming that the perimeter and in-scope infrastructure is adequately secured, by a PCI DSS certified security assessor) was provided for our review, valid up to the 11th March 2017. Screenshots were also provided for our review, confirming that Anti-Virus software, which cannot be disabled by end users, is installed on all computers used to process payments.

In scope infrastructure items are known (all infrastructure where card details are entered, or through which details ‘pass’ on route to the Council’s payment processor), although a formal register of these items, beyond data flow charts (provided for our review), is not maintained. The majority of credit card payments processed by the Council are taken via online payment pages, either directly by members of the public via iwight.com or by Council staff, primarily in the Contact Centre. However there are a number of Point of Sale Machines (PoS) used, for example at Medina Theatre and at the Heights Leisure Centre. While these connect to the payment processor over the Council’s network rather than over dedicated lines, vendor documentation has been provided to us stating that the equipment is PCI DSS compliant, with all data transfer encrypted. For wireless PoS machines, vendor documentation identified that PCI DSS 3.0 compliance is ‘optional’ – confirmation should be sought from vendors that the machines used by the Council include this optional functionality.

The addition of any new infrastructure items requires approval from Change Advisory Board, with changes managed as incidents through LANDesk, the Council’s IT Service Desk system. There has been one change in-year, to the PoS machine used in the Medina Leisure Centre bar; screen shots from LANDesk were provided to us regarding this change, showing its approval prior to installation.

Management of both in-scope infrastructure and teams responsible for processing payments would benefit from being formalised, this is particularly relevant for where these items sit in less secure areas, for example PoS machines. The best approach would be to introduce a register of all items with key metrics, for example location, usage, ownership, serial numbers etc. Linked to this (associated with Version 3.0 PCI DSS) a record of checks made should also be considered, for example validating the serial numbers of PoS machines in situ (to prevent the substitution of devices) and for the presence of key logging devices. Regarding the teams responsible for taking payments a similar approach should be considered, including the recording of appropriate metrics, for example usage, card volumes, training provided to staff etc.

Risks

Failure to maintain unbroken PCI DSS compliance may lead to withdrawal of the Council’s ability to process card payments, impacting on revenue collection and potentially lead to regulatory fines.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;">Medium</p>	<p>The Strategic Manager ICT & Digital Services will:</p> <ul style="list-style-type: none"> • Put in place a formal register of in scope infrastructure items, including all PoS machines. <p>The Leisure Facilities Manager will:</p> <ul style="list-style-type: none"> • Confirm that wireless PoS machines include optional compliance with PCI DSS 3.0. 	Gavin Muncaster, Strategic Manager ICT & Digital Services Lawrence Edmonston, Leisure Facilities Manager
		<p>Target Date</p>
		<p>March 2017</p>
		<p>Report reference:</p>
		<p>IOW- 06-02</p>

7. Responsibilities and Training – control design

Finding

There are a variety of activities necessary to support ongoing PCI DSS compliance. For the majority of these, responsibility is implicitly understood. For example, the IT Compliance & Infrastructure Manager is responsible for ensuring that an appropriate programme of external penetration tests is carried out, with the Technical Support Lead responsible for completing and submitting the annual SAQ. However it would be helpful for all of these activities to be documented in a single document, including identifying who is responsible for ensuring that each activity is carried out satisfactorily. This is likely to be particularly salient for a number of activities identified in the action plan of planned PCI DSS enhancements, for example implementing a regime of regularly checking PoS machines for the presence of key loggers (hardware devices, which can capture PINs when they are entered on PoS machines).

It may also be helpful for a single, senior officer to formally take responsibility for ensuring ongoing PCI DSS compliance. Implicitly this sits with Strategic Manager ICT & Digital Services, although historically (at the time of our last review of this area, in 2014/15) it sat with the Business Centre Manager. Neither of these officers are ideal, taking card payments is a 'business' rather than a 'technical' function and card payments are processed in a number of areas, primarily, but not fully, located under the Business Centre Manager. One approach could be for overall responsibility to sit with Corporate Finance, an approach we have observed at other organisations; where overall responsibility for PCI DSS should best sit should be escalated to senior management for decision.

As noted above, one of the main areas of the Council where card payments are processed is the Business Centre, primarily within the Contact Centre. We confirmed that call recording is not enabled on the Avaya telephone system (to ensure that card details are not inadvertently captured) and that webpages, both public facing and those used to process payments internally, are configured to ensure that card details are not stored. We also noted that staff are prohibited from having mobile phones in the Contact Centre, which removes the potential for these to be used to capture card payment detail.

However, while we were informed that PCI DSS requirements are implicitly covered in induction/training to Contact Centre staff, these are not explicitly covered in training materials. As identified on the action plan of planned PCI DSS enhancements training should be provided to all staff involved in processing payments, both in the Contact Centre and elsewhere, for example staff in leisure centres using PoS machines. This should cover key expectations and a level of awareness training, for example ensuring staff are vigilant for the presence of key loggers on PoS machines, associated with this a register should be maintained by staff who have completed training.

Risks

Unclear allocation/documentation of responsibilities, increasing the likelihood that gaps may exist, or that controls may not be exercised consistently, increasing the likelihood that PCI DSS compliance may not be maintained and potentially that card holder data may be compromised, leading to reputational damage and regulatory fines.

Failure to provide appropriate training, potentially leading to staff being unaware of and consequently not complying with requirements, leading to card holder data being compromised, reputational damage and regulatory fines.

Finding rating	Agreed actions	Responsible person / title
<p style="text-align: center;">Medium</p>	<p>The Strategic Manager ICT & Digital Services, delegating/collaborating as necessary, will:</p> <ul style="list-style-type: none"> • Escalate to senior manager for decision as to where overall responsibility for PCI DSS best sits to ensure organisational compliance • Identify and document all activities necessary to maintain ongoing PCI DSS compliance, including responsibility for each activity. 	<p>Gavin Muncaster, Strategic Manager ICT & Digital Services Cate Sheen, Contact Centre Manager Lawrence Edmonston, Leisure Facilities Manager</p>
		<p>Target Date</p>
	<p>The Strategic Manager ICT & Digital Services, in collaboration with the Contact Centre Manager and Leisure Facilities Manager will:</p>	<p>March 2017</p>
	<ul style="list-style-type: none"> • Document induction/training for staff involved in processing payments, covering key PCI DSS requirements and awareness. • Implement a record of training provided. 	<p>Report reference:</p>
		<p>IOW- 06-03</p>





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

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

Report classifications

Findings rating	Points
Critical	40 points per finding
High	10 points per finding
Medium	3 points per finding
Low	1 point per finding

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

Appendix B: Terms of Reference

Background and Scope

PCI DSS is the standard which organisations wishing to take card payments need to comply with.

This area was last reviewed in 2013/14; since our last review of this area there has been a major review of the standard.

This audit will review the arrangements the Council has in place against PCI DSS 3.0, identifying any gaps which need to be addressed, helping to ensure the following are addressed:

- *Core Technical Requirements:* completion and submission of the Self-Assessment Questionnaire (SAQ), penetration testing, Point of Sale (PoS) machines, responding to infrastructure changes and having appropriate anti-virus software in place.
- *Core Non-Technical Requirements:* assigned responsibility for PCI DSS, mechanisms to ensure cardholder details are not inadvertently captured, identifying and responding to any changes at the Council, impacting on PCI DSS.
- *PCI DSS Version 3.0 Changes:* identifying and responding to any changed requirements introduced by PCI DSS 3.0.

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

#	Control objective	Potential risks
1	<p>Core Technical Requirements A Self-Assessment Questionnaire (SAQ) has been submitted and passed as PCI DSS compliant.</p> <p>A recent external penetration test has been completed and passed as PCI DSS compliant; future tests are scheduled, in line with PCI DSS requirements.</p> <p>Where third party hardware, for example Point of Sale (PoS) machines, is used, appropriate documentation has been provided by vendors, certifying their equipment as PCI DSS compliant.</p> <p>A process is in place to identify and document in-scope infrastructure items (all infrastructure, from capture of payment details, through to sending details to payment processors). Up to date anti-virus software is installed on all in scope infrastructure items, including terminals used by staff to process payments; anti-virus software cannot be disabled by end users.</p>	<p>Failure to comply with PCI DSS requirements will:</p> <ul style="list-style-type: none"> • Lead to reputational damage for the Council. • Withdrawal of the ability to process card payments, potentially leading to loss of income and additional costs in order to process payments using different mechanisms. • Significant regulatory fines. <p>More specifically:</p> <ul style="list-style-type: none"> • If assurances are not provided by third party vendors then assumptions may be made regarding the status of their systems, potentially leading to inadvertent PCI DSS noncompliance by the Council. • If a process is not in place to ensure all in-scope infrastructure items have been identified then assumptions may be made, potentially leading to inadvertent PCI DSS noncompliance by the Council. • If up to date anti-virus software is not in place then malware could lead to capture of cardholder data by third parties, leading to PCI DSS noncompliance by the Council.
2	<p>Core Non-Technical Requirements Responsibility for leading/managing the process to ensure ongoing PCI DSS compliance to assigned to an appropriate officer.</p>	<p>Failure to comply with PCI DSS requirements will:</p> <ul style="list-style-type: none"> • Lead to reputational damage for the Council. • Withdrawal of the ability to process card payments, potentially leading to loss of income

#	Control objective	Potential risks
	<p>Appropriate measures are in place to ensure that cardholder data is not inadvertently stored, specifically:</p> <ul style="list-style-type: none"> • Call recording is not enabled when telephone payments are taken. • Webpages are configured to ensure card details are not stored. • The importance of not recording payment details has been highlighted to staff, for example through induction/ongoing training. <p>A process is in place to identify changes to processes/structures which may impact on the Council's mechanisms to ensure ongoing PCI DSS compliance, specifically:</p> <ul style="list-style-type: none"> • Any new mechanisms/infrastructure to process payments. • Any changes to/new teams processing payments. 	<p>and additional costs in order to process payments using different mechanisms.</p> <ul style="list-style-type: none"> • Significant regulatory fines. <p>More specifically:</p> <ul style="list-style-type: none"> • If responsibly for PCI DSS is not clear, then the process of ensuring compliance is less likely to be exercised consistently. • If mechanisms are not in place to ensure that cardholder data is not inadvertently captured then the potential for this to happen will increase, invalidating the Council's PCI DSS assertions. • If changes are not identified then the assertions made in the SAQ may be incorrect, invalidating the Council's PCI DSS compliance.
3	<p>PCI DSS Version 3.0 Changes The Council has responded appropriately to any new/changed requirements introduced by PCI DSS 3.0, specifically:</p> <ul style="list-style-type: none"> • The SAQ has been reviewed to identify changes. • Any areas where the Council's arrangements need to be enhanced have been identified and addressed (SAQ Part 4); we will check a sample of new/changed arrangements for testing. • Where compensating controls are utilised these have been appropriately documented (SAQ Appendix B). 	<p>Failure to comply with PCI DSS requirements will:</p> <ul style="list-style-type: none"> • Lead to reputational damage for the Council. • Withdrawal of the ability to process card payments, potentially leading to loss of income and additional costs in order to process payments using different mechanisms. • Significant regulatory fines. <p>Failing to respond appropriately to PCI DSS 3.0 will invalidate the Council's PCI DSS ongoing compliance.</p>

Audit approach

Our audit approach is as follows:

- Obtain an understanding of PCI DSS arrangements and controls through discussions with key personnel, system walkthrough and review of procedure documentation.
- Identify the key risks to these arrangements and controls.
- Evaluate the design of the controls in place to address the key risks.
- Test the operating effectiveness of the key controls.

Appendix C: Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken the review of PCI DSS compliance 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 PCI DSS compliance is for controls effective from 1st April 2016 to 1st 3rd January 2017. 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.

Management Responses Received

Highways and Waste Contract Management follow up

It is disappointing that the overall finding remains at high risk in respect of the Highways PFI contract . as has been covered in the detail of the audit and evidence provided the Highways PFI contract is an immensely complex contract covering a significant area of activity which contains a vast range of complex performance management standards and a complex method for assessment of performance. The report accepts that at a strategic level that the approach to management has improved and that the really key areas of performance in respect of Milestone payments has been “ more robustly managed” and this remains the case.

The risk finding appears to be heavily driven by lack of progress on the action plan that was recommended from the initial audit . however between the first audit and the repeat audit the lack of progress on what was probably always an ambitious plan can be explained by the diversion of resource and particularly management resource to continuing to resolve a range of contract interpretation issues with the Service provider. This position was taken to ensure that the various long term financial risks of contract interpretation could be contained. At the same time the council was also having to manage the impact of the introduction of the new waste contract that is briefly referred to within the report. This also has involved considerable management resource given the need to procure a new subcontractor due to the previous contractor Energos entering administration in mid 2016. This exercise coincided with the period during which the PFI action plan was to be developed. The new subcontractor was procured in April 2017 but the period involved in dealing with this was extensive given the need to undertake correct procurement and technical and financial due diligence.

Pan Meadows

The outcome of the audit is noted and it is acknowledged that the audit area considered to be high risk relates specifically to the difficulties that have arisen due to succession planning, record keeping and lessons learned. It is accepted that this had resulted in the loss of “organisational memory” and accepts that for a project of this size measures should be taken to improve on this. However in considering the report as a whole it should be noted that the Pan Management Company is now correctly constituted and that it has now employed a professional management company. The position remains as set out in the summary that the council is confident that issues can be resolved during the next 6 to 12 months or so. However the report also refers to the successful early delivery of the social housing which was one of the drivers for the development. It also cannot be overstated that due to the physical configuration of the development including extensive levels changes, the provision of a spine road link that transects the development, the provision of a district heating system and that development rates now rely on the private sector that some of the original intent and metrics within the Development Agreement are probably now out of date.

In respect of the specific recommendations relating to Performance management/ reporting and environmental targets management is of the view that these should be reviewed jointly with the Development Agreement Partners in view of the passage of time since the original DA was completed. This exercise is most likely to involve the council and barratts but it is recommended that Sovereign should be approached to see if it wishes to input into these discussions. A realistic timeframe should be developed with the partners to complete that review.