AUDIT & RISK MANAGEMENT UNIT

AUDIT REPORT

FOR

URBAN VISION

CADISHEAD WAY PHASE 2 PROJECT

REF: 2878/UV/05

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EXECUTIVE SUMMARY

Introduction & Scope

The construction of the Cadishead Way Stage 2 was started in February 2004 and the new road opened on 16th September 2005. The road runs between Brinell Drive in Irlam and Salford's boundary with Warrington at Glazebrook. It connects with Stage 1 of the bypass that was opened in 1992.

The objectives of the new route were to improve the quality of life for residents and businesses along Liverpool Road, by reducing the heavy traffic flows, and also to boost economic prospects for the area by providing more direct access from the motorway to the Northbank Industrial park.

The contract used as the basis for this project was the New Engineering Contract (NEC) option C. Option C sets a target price for the contract; any savings from this price are split 50:50 between the contractor and Salford City Council (known as the gain share). If the costs are above the target price by less than 10% this additional cost is also split 50:50 (known as the pain share). Above that amount 80% of the pain share is borne by the contractor.

During the progress of a contract the target price may move up or down. These movements can be due to changes in the specifications of the work, or unforeseen problems. These changes are known as compensation events. A compensation event cannot be raised for any inefficiency or rework needed by the contractor.

It is currently estimated that the final cost to Salford City Council will be approximately £230,000 less than the original contracted target price. The saving over the final target price is likely to be in the region of £860,000. The largest change in the target price was caused by unforeseen problems with the ground conditions on site.

The project has also won a silver “Considerate Constructors” award and has just won the “Builder & Engineers Pubic Project Award” for 2005.

Urban Vision management felt that the costs and controls around the Cadishead Way project were robust, however, due to the amount of expenditure involved and the pioneering approach used, they asked Internal Audit to provide assurance that their assessment was correct. They also recognised that, it is also important to learn any lessons from this scheme that can be taken forward to future contracts.

The scope of the audit work undertaken was to assess the adequacy of the controls in place to ensure:

- Compliance with the financial aspects of the contract document
- The open book accounting review and challenge of the monthly assessments supplied by Birse was robust
- Monthly payments made to Birse were accurate
- The Target price was adjusted correctly for compensation events.

In order to review the above open book accounting controls whilst they were still in operation, and the site office was still in use, it was not possible to perform a detailed audit of the final account of the project. However, due to the nature of the partnership contract and the open book accounting methodology, the above review will assist in providing assurance as to the accuracy of these figures.

The audit fieldwork was conducted at the site office and in the Legal Department during September and October 2005.

Audit Opinion

Overall the Cadishead Way phase 2 project can be regarded as a success. The road was opened several months early and at a considerable saving to Salford City Council. In calculating the saving it is necessary to understand the nature of the contract.

Our audit review showed that the general control environment was strong reflecting the good relationship between the partners.

Monthly assessments and payments

Using the NEC contract option C the contractor partner (in this case Birse) submits monthly assessments to Urban Vision for checking and these are subsequently paid by Salford City Council. The Birse assessments were not as detailed as is usually required for open book accounting and this lead to an increased need for extra back-up documentation and an increased number of queries. Urban Vision employed an independent Quantity Surveyor to conduct the monthly challenge and review process. Our audit found that this monthly challenge process was robust, a list of all queries was kept, and a copy of the responses was also kept on file. All the payments sampled were accurate and the parameters used in the assessment calculation were in agreement to the contract document.

Definition of Actual Cost

A realistic approach to the partnership and the interpretation of the contract was a key to the success of the project. The main area of debate was around the interpretation of the term “actual cost”. The contract states that the amount due for payment each month is the “Price of the work done to date”. The “Price of the work done to date is defined as the “Actual Cost which the contractor has paid plus the fee”. If this definition is interpreted strictly the contractor could not be paid for any subcontractor work done or goods received on site for which the contractor had not actually made payment. To interpret the contact this way makes administration for the client side more complex and can cause significant cash flow problems for the contractor, especially on a large contract.

The interpretation used on this project was based on work done and goods received on site at the assessment date. Audit’s opinion of this change is that there is no risk to the Authority as payment is only made for goods and work we have received. Using the accruals method of payment seems more in line with the partnership spirit of Rethinking construction.

Early Payment of Contractor Share

In March 2005 the contractor, Birse, requested an early payment of part of the gain share that they expected to receive at the end of the contract. They offered to forego £10,000 of their final gain share if they could receive £240,000 at this early stage. The Lead Member was provided with all the forecast financial information and a risk assessment showing that the project team considered the main project risks to be behind them as the project reached completion stage. However, the Decision Notice showed no evidence of legal advice being taken. We believe that it would have been prudent to take legal advice to ensure that no precedent was being set which would make it difficult to refuse an early gain share payment in less favourable circumstances.

Quantity Surveyor Role

As mentioned earlier in the report Urban Vision used a self-employed independent quantity surveyor to examine the monthly assessments and to review the changes to the target price. This role is pivotal to the smooth running of the contract. Urban Vision should consider whether there is enough work to employ a full-time QS in the area of highways projects as this may present better value for money.

More minor issues and recommendations on the above issues are contained in the main body of the report.

FINDINGS

Early Payment of Gain Share

Finding	In March 2005 the contractor, Birse, requested an early payment of part of the gain share that they expected to receive at the end of the contract. They offered to forego £10,000 of their final gain share if they could receive £240,000 at this early stage. The Lead Member was provided with all the forecast financial information and a risk assessment showing that the project team considered the main project risks to be behind them as the project reached completion stage. However, the Decision Notice showed no evidence of legal advice being taken. We believe that it would have been prudent to take legal advice to ensure that no precedent was being set which would make it difficult to refuse an early gain share payment in less favourable circumstances.
Priority	High
Recommendation	Legal Advice should be sought in retrospect so that any potential future issues can be identified. Also, if there are any major deviations from the contract terms in future legal advice should sought prior to the decision going to the Lead Member so that he has all the information he needs to make a fully informed decision.
Management Response	Comments will be sought from the Law and Administration section of Salford City Council in order to identify any potential issues that may arise in the future as a result of these actions. It is not intended that such advance payment will become a common occurrence but it was paid in this instance to acknowledge the commitment to the success of the scheme.
Timescale	Completed
Staff Responsible	D A Dean (Group Engineer Highways)

Quantity Surveyor

Finding	Under partnership working, the role of the Quantity Surveyor (QS) is pivotal to the smooth running of the contract. The role of the QS is to work alongside the project manager and examine and challenge the monthly assessments and compensation events that may casue changes to the target price. On the Cadishead way phase 2 project, a self-employed independent quantity surveyor was contracted to examine the monthly assessments and to review the changes to the target price.
Priority	High
Recommendation	Urban Vision should consider whether there is enough work to employ a full-time QS in the area of highways projects as this may present better value for money. This is especially in light of the fact that Urban Vision are likely to be taking on the management of more large highways projects as they increase the amount of non-SCC work they undertake.
Management Response	At present the volume of work within the office would not justify such an appointment. Should circumstances change however this position will be reviewed
Timescale	N/A
Staff Responsible	Paul Garrett (Associate Director)

Compensation Event

Finding	When a change is to be made to the target price a compensation event form is completed. This form shows the reason for the change and has an agreed cost / saving of the event. The form is then signed by the Contractor and by the Urban Vision Project Manager (on behalf of SCC). During our audit a compensation event form was sampled on which the cost of the CE had been changed after the Urban Vision Project Manager had signed the form but before the Contractor had signed. On discussion with the Project manager it was clear that he was aware of the changes but had not resigned the form.
Priority	Medium
Recommendation	On future projects it is important that the Project manager signs the CE agreement form after any changes are made. The CE events change the target price and as such it is important to be able to demonstrate that any changes have been properly agreed and authorised.
Management Response	The controlled CE was maintained by the QS and is considered to be correct. The Project Manager should not have signed a copy of the CE before final agreement had been reached with the Contractor. In future the Project Manager will only sign the agreed CE.
Timescale	01/11/05
Staff Responsible	D A Dean (Group Engineer Highways)

Salford City Council

CADISHEAD WAY PHASE 2 PROJECT

Signed _____

Principal Auditor

Signed _____

Audit Manager

In the event of any query, please contact:

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