

Review of Capital Expenditure

Sedgefield Borough Council

Audit 2007/08

September 2008



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Status of our reports

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- any director/member or officer in their individual capacity; or
 - any third party.
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Summary report

Introduction

- 1 The Council budgeted to spend £26m on capital expenditure in 2007/08, which represented a doubling of the capital programme in just three years. The majority of the expenditure related to housing schemes. In February 2008, the Council entered a partnership agreement with MEARS construction covering the delivery of all capital works, repairs and maintenance for the Council's housing stock. It is currently consulting tenants about a proposal to transfer the entire stock to a registered social landlord (Sedgefield Borough Homes) in early 2009 and is considering transferring responsibility for regeneration capital projects to a local authority owned company. It is trying to conclude this significant organisational change before the Council is abolished as part of local government re-organisation in April 2009.
- 2 In 2007/08, almost half the capital expenditure was incurred in the final two months of the year and £4m was re-profiled for completion in 2008/09. It is not unusual for authorities to spend a large proportion of their capital expenditure in the final quarter but the extent of the uneven expenditure in 2007/08 is unusual and raises concerns over value for money. It will also be difficult to accommodate significant slippage in 2008/09 because of LGR and stock transfer.
- 3 The Audit Code of Practice requires us to give an annual opinion on the Council's arrangements for value for money and we decided that we needed to review your arrangements for managing capital projects before giving this opinion in view of:
 - the value and rate of increase of capital expenditure;
 - the concentration of capital expenditure in the final two months;
 - the significant change in management arrangements as a result of the MEARS partnership; and
 - the impact on capacity of plans for LGR and housing stock transfer.

Background

- 4 We last reviewed capital project management at Sedgefield in detail in 1996. We found capital projects to be '*well-managed*' with high levels of user satisfaction, fewer delays than usual and overall costs within budget. The report only identified a few enhancements to existing good practice. However, the capital programme at the time amounted to £8m and the greatest part was allocated to '*tenant-led improvement (TLI)*' schemes, which ended in 2005.

Audit approach

- 5 We focused our review on housing capital projects because the only significant non-housing capital scheme concluded in 2007/08 was a one-off leisure scheme that is currently the subject of a legal dispute.
- 6 The Council completed a questionnaire in respect of the last 16 capital projects to reach practical completion as at 31 March 2008 and we analysed the results using national benchmarks to assess adherence to cost and timetable. We discussed the arrangements for managing capital projects both before and after the MEARS partnership with the Head of Housing Property Services and Design and Management Manager. We also reviewed a file of evidence including tenant satisfaction surveys and project monitoring reports.

Main conclusions

- 7 The Council continues to manage capital projects well and there are no issues that would prejudice our unqualified VFM Conclusion. Tenant satisfaction remains high, the extent of delays is less than the national average and the housing capital programme was 6 per cent under-spent overall.
- 8 Although only 30 per cent of the capital programme was spent in the first half of the year, this was due primarily to the amount of time spent preparing for the transfer of staff to MEARS and the unprecedented levels of sickness amongst in-house staff following the issuing of redundancy notices in July 2007. Early indications are the partnership is working well with high tenant satisfaction maintained, significantly reduced design, tender and mobilisation periods and a commitment to freeze prices throughout the three-year contract.
- 9 We identified a few further enhancements to good practice that may prove necessary to ensure that capital projects continue to be managed well in 2008/09 when capacity will be stretched by preparations for LGR and housing stock transfer.

Main findings

Cost

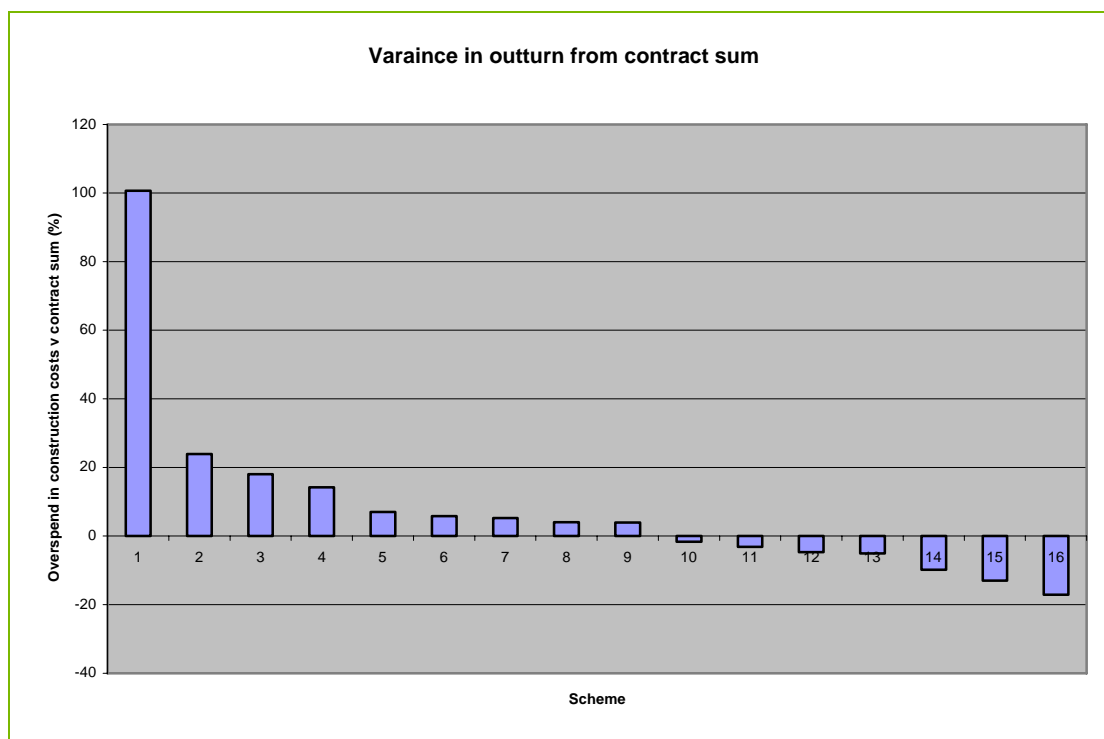
- 10 The Authority has consistently kept overall capital spending within the capital budget. Under-spends have usually been below 10 per cent by year-end although a disproportionate level of expenditure has taken place in the final quarter. In 2007/08 the HRA Capital Programme was under-spent by 6 per cent and the under-spend on the last 16 projects completed was just 1 per cent, but delays in processing compulsory purchase orders held up the demolition of private houses resulting in £4m of the general fund capital programme being re-phased to 2008/09.

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- 11** The tight overall budgetary control disguises significant variation on individual projects. Figure 1 illustrates that the costs of 63 per cent of projects varied by over 5 per cent from the contract sum, compared to 50 per cent nationally. This was partly because half the central heating schemes completed were extended during construction to cover significantly more properties than contracted. However, even excluding the extended contracts the level of cost variation was above average.

Figure 1 Level of cost variation during construction

The Council's capital projects were more prone to cost variations than the national average of 50 per cent of schemes within 5 per cent.



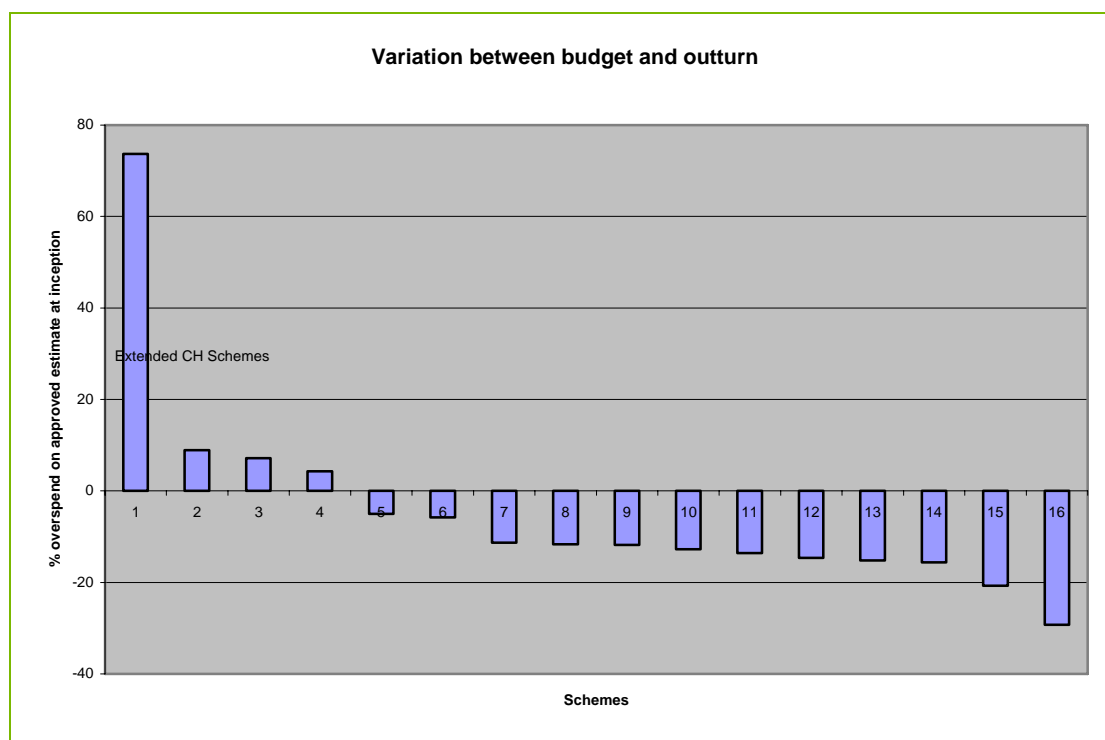
Source: Audit Commission survey of last 16 capital projects completed by 31 March 2008

- 12** The Audit Commission found that the later in a capital project changes happen the more costly they are and we suggested in our 1996 report that project briefs are frozen before tenders are invited. However, the Council does not freeze briefs because:
- the scope is often extended where tenders are much more competitive than expected; or
 - tenants have failed to confirm their design choices.

13 Excluding extended contracts, 92 per cent of projects were under-spent against their initial estimate. The Council uses appropriate methods to estimate costs based on historic unit costs and published BICS rates but assumes that all properties have the maximum specification and costliest design choices available and this tends to overstate budgets. Many tenants decide to keep existing fittings such as stone fireplaces rather than get them updated with the wooden fire surrounds offered by the Council but this isn't assessed until after projects have been approved. The extent of variation against budgets is displayed in figure 2.

Figure 2 The Council tends to under-spend against initial estimates

75 per cent of projects under-spent but excluding extended central heating schemes the figure is 92 per cent.



Source: Audit Commission survey of last 16 projects completed at 31 March 2008.

14 The Council gave valid reasons for extending the scope of the central heating schemes either through varying the terms of a contract (as happened in schemes 1-3 above) or through negotiating follow-on contracts with the contractor. There were some especially competitive prices received from tendering in 2007 and the chosen contractor delivered good value for money. Extensions were discussed with the section 151 Officer and Monitoring Officer and most negotiated contracts formally approved by the Cabinet. However:

- the authorisation and the supporting justification was not always evidenced;
- the negotiated follow-on contract (89624) was not approved by Cabinet as required by the Constitution (Contract Procedure 8) due to a shortage of time to complete planned work by the year-end and hit decent homes standard targets;

Summary report

- this contract was vastly extended in scope from 208 to 372 properties but the only documented authorisation was a contract administrator's instruction signed by a quantity surveyor; and
- in packaging contracts for 2008/09 the Council and its partner have not increased the size of central heating schemes to give more firms the opportunity to exploit economies of scale and avoid the need for further extensions.

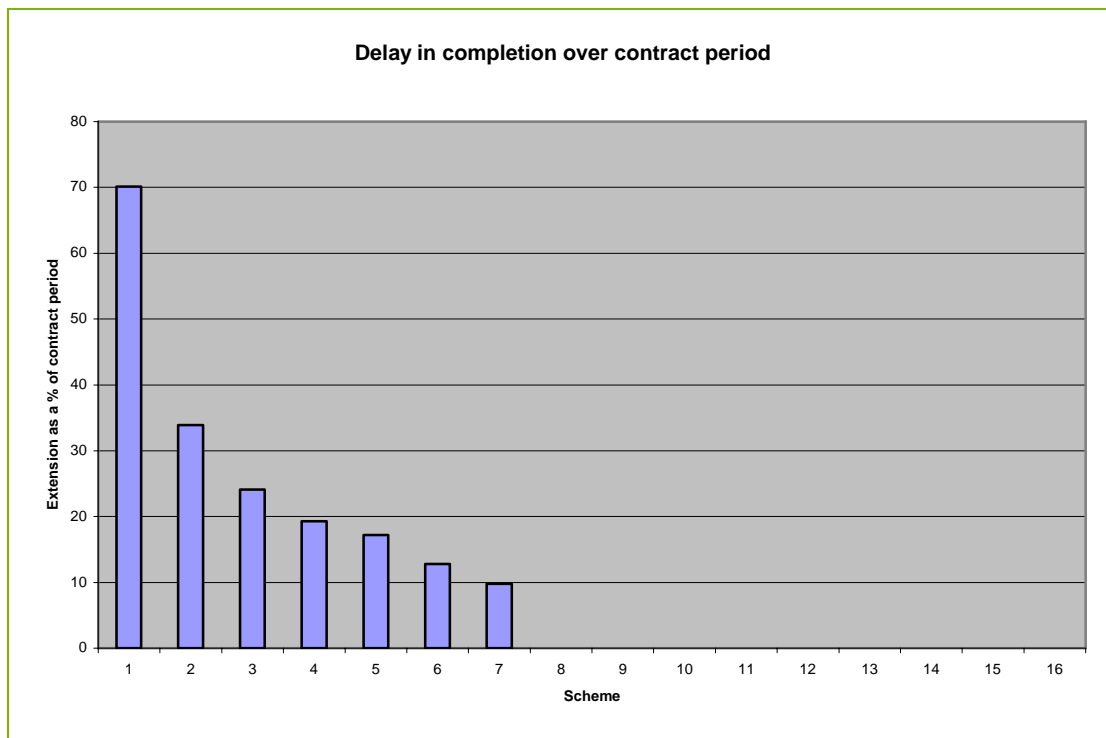
15 The financial monitoring of capital projects is at a much higher level than the monitoring of physical progress. The Housing Services Group Report gives monthly information on the physical progress of each capital project but the Housing Working Group's financial monitoring report is at programme element level and the reports to Cabinet are by service area. Thus, significant variances on individual projects such as those on project 89624 where the outturn was twice the contract sum might not be appropriately scrutinised. Capital budget holders receive capital budgetary control reports at scheme level and whilst this format might be too detailed for reporting to Members the reports to Cabinet and the Housing Working Group should at least show expenditure against budget on each major capital project.

Timeliness

16 Although high in-house sickness levels meant that capital projects tended to take longer to complete in 2007/08 than usual with 43 per cent of expenditure in the final two months the Council continued to perform better than average at adhering to project timetables. Exhibit 3 shows that 56 per cent of capital projects were completed on time compared to a national average of just 25 per cent and the average delay was 27 days compared to 57 days nationally.

Figure 3 Delays in contract completion

The Council completed most capital projects on time and delays were relatively minor with the three biggest delays being due to the extended contracts.



Source: Audit Commission survey of last 16 capital projects completed at 31 March 2008

17 The proportion of delayed starts, the design and tender period and the mobilisation period from contracts being let to start on site are all fairly average but MEARS have reduced these periods considerably and were able to start some construction work on site in April 2008. This is important because the Council will wish to minimise work in progress at 31 March 2009 when the Council is due to be abolished and the housing stock transferred to a registered social landlord.

Quality

18 In our 1996 report we found that the Council had the highest level of user satisfaction in the County and this high level of satisfaction has been sustained. Overall satisfaction has been consistently about target, averaging 86 per cent in 2007/08 compared to 83 per cent the previous year. There were lots of quality safeguards in contract prelims and tendering procedures and tenants continue to be extensively consulted with dedicated liaison officers and representatives on working groups. However, only 38 per cent of tenant satisfaction surveys were returned with response rates varying from 16 per cent to 66 per cent.

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Recommendations	
R1	Impose a deadline for tenants to confirm design choices so specifications can be frozen prior to inviting tenders.
R2	Record the authorisation and justification for extended contracts and negotiated follow-on contracts.
R3	Discuss the potential for packaging central heating schemes into larger contracts with the housing partner.
R4	Ensure that financial monitoring reports to Cabinet and the Housing Working Group link the more detailed monitoring of physical progress to the financial progress of each major capital project.
R5	Agree arrangements for capital work in progress at 31 March 2009 with successor bodies.
R6	Use tenant liaison officers to chase up unreturned satisfaction surveys.

Appendix 1 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
9	R1 Impose a deadline for tenants to confirm design choices so specifications can be frozen prior to inviting tenders.	3	Head of Housing Property Services	Agreed		30 September 2008
9	R2 Record the authorisation and justification for extended contracts and negotiated follow-on contracts.	3	Head of Housing Property Services	Agreed		30 September 2008
9	R3 Discuss the potential for packaging central heating schemes into larger contracts with the housing partner.	2	Head of Housing Property Services	Agreed	These discussions have now taken place and larger contracts are planned for the next round of central heating contracts.	Implemented
9	R4 Ensure that financial monitoring reports to Cabinet and the Housing Working Group link the more detailed monitoring of physical progress to the financial progress of each major capital project.	2	Deputy Director of Finance	Agreed		30 November 2008
9	R5 Agree arrangements for capital work in progress at 31 March 2009 with successor bodies.	2	Head of Housing Property Services	Agreed		30 November 2008
9	R6 Use tenant liaison officers to chase up unreturned satisfaction surveys.	1	Head of Housing Property Services	Agreed		30 November 2008

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