

Public Interest Report

December 2007



Public Interest Report

Leicester City Council

Audit 2006/07

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Report in the Public Interest

Introduction

- 1 Section 8 of the Audit Commission Act 1998 requires me to consider, whether in the public interest, I should make a report on any matter coming to my notice during the course of an audit so that it may be considered by the Council or brought to the attention of the public. Having consulted upon it, this report is made in accordance with that statutory requirement.
- 2 In summer 2006 a disclosure was made to the Audit Commission under the Public Interest Disclosure Act 1998 concerning Leicester City Council (the Council). The allegations in the disclosure concerned housing repairs and improvements contracts entered into by the Council. This report sets out the findings in relation to my investigation of the allegations. The period covered by the findings is 2001 to 2006.
- 3 As far as possible the anonymity requested by the discloser will be respected. The discloser has made a substantial contribution in making the disclosure and by drawing attention to matters that are of public interest.

Background

- 4 The City Council is the largest housing landlord in Leicester, providing 23,500 dwellings. The Council aims to bring all of its housing up to the decent homes standard, a national standard, by 2010. The Council hopes to exceed this standard and this is an important strategic objective for the Housing department.
- 5 In 2006/07 the Council's repairs and improvements budget provided £28.2 million for capital works and a further £22.4 million on revenue schemes. Within the capital budget, £24.3 million was provided to fund works to enable the Council to meet the decent homes standard; the biggest items being: kitchen/bathroom improvements (£9.8 million) and window/door replacements (£7.2 million).
- 6 Most work carried out to meet the decent homes standard is procured through external contracts but some work is delivered in-house. Technical Services is responsible for the management of housing repairs and improvements. The Director of Housing (now also responsible for adult and community services) has overall responsibility for the Housing function.
- 7 The matters covered by this report mainly relate to capital works, carried out to meet the decent homes standard. During the audit we examined:
 - all issues raised in the public interest disclosure;
 - strategic and operational management processes;
 - compliance with the corporate procurement framework; contract and finance rules and EU procurement rules;

- eight major procurement exercises contracts carried out by the former housing department and subsequent contract management thereof; and
 - relevant aspects of corporate governance.
- 8 We were not able to interview the former Service Director (Housing Technical Services) who oversaw the housing repairs function during most of the period of review as he sadly died before our work commenced. In addition, the Technical Manager (Building) declined an opportunity to comment on the draft report.
- 9 During the course of this work I have interviewed Council staff as well as persons associated with external contracting companies. I have also reviewed a substantial amount of documentation and received wide comment from those referred to in this report. The scope of my work has however focused on the Council's role in relation to the matters examined. My role, has not been to make any judgments about the role or conduct of any parties external to the Council (who have been anonymised in this report), but rather, to ascertain whether the failings described in the report could have been avoided by the Council's actions.
- 10 The remainder of this report sets out our broad findings. A separate detailed report has been made available to the Council.

The overall picture

- 11 Previous inspections of the management of the Council's social housing have shown that the Council provides an effective service to tenants, which is generally well-regarded. This largely remains the case. Outcomes are delivered and good progress is being made towards meeting the Leicester decent homes standard (DHS) by 2010. Expenditure on works to meet the DHS has grown substantially in the last seven years to the present level of £24.3 million (in 2006/07). However, the arrangements put in place to manage the rapidly growing DHS budget proved inadequate in our view.
- 12 In particular, our audit identified serious failings in the procurement and management of some major housing repairs and improvement contracts, referred to us by the discloser, which go back six years. Significant flaws in tendering and contract management procedures were at that time neither addressed nor identified by senior housing management. At the heart of these failings was an absence of effective controls at a local level, which were not detected by corporate long-stop controls, and a reporting regime which provided inadequate information to enable governance to be scrutinised. Not all of the contracts we examined however exhibited these failings.
- 13 Achieving the DHS was a key corporate risk for the Council, not least as the growing spend was accompanied by an increased use of large scale contracts of significant value and long duration. This required the Council to develop management and procurement skills to ensure that good value continued to be delivered and sound governance preserved. The failings in contract management and evaluation identified by our audit, demonstrate that the Council did not invest adequately in these skills at that time.

- 14 These failings also arose as a result of a lack of basic management controls and poor scrutiny and oversight of tendering and contract management processes. Scrutiny was important, not least as segregation of duties, a key control to prevent fraud and collusion, did not operate effectively within Technical Services. As a result a small number of Technical Services officers were able to make key decisions about multi-million pound contracts without effective scrutiny or oversight. This put the Council at risk.
- 15 Responsibility for making these and other key decisions was at a number of levels and was complicated by the shifting roles and job titles of staff involved during this period, particularly in Technical Services. Responsibility was hard to pin down, shifted over time and decision processes did not necessarily remain constant from contract to contract. This led to a lack of accountability, insufficient monitoring, and major decisions being made at a relatively low level of the organisation. The rest of this report provides more detailed examples of how these problems arose and the action the Council is taking to address these problems.

Tendering processes

- 16 The failings outlined above were apparent in the letting of a number of major contracts, the most significant failing relating to non-compliance with European Union (EU) public procurement rules. EU rules require large contracts above defined thresholds to be advertised in European Journals to stimulate competition in order to deliver cost benefits to clients. Failure to follow the EU rules undermines good governance and can lead to legal challenge by unsuccessful contractors. Of the contracts we examined, some complied with the EU rules, however other contracts, with a total spend of at least £21 million between 2001 and 2006, have been tendered and awarded in breach of the EU competition requirements, in our view.
- 17 The way in which this happened is best illustrated by the UPVC windows contract. The contract had an estimated annual value of £100,000 when it was let in October 2001, well below the EU works threshold of 5 million ECU (£3.7 million). However, in practice, cumulative payments to June 2006 amounted to £6.7 million, considerably in excess of the EU procurement thresholds. Officers stated that the contract had originally been envisaged on a smaller scale to support the in-house work programme, but a decision to accelerate the window replacement programme meant that more work was required from the external contractor. This should have been clear at a relatively early stage and the contract should have been re-tendered under EU rules in 2005/6. This did not happen.
- 18 Not only did the letting and management of the contract involve a breach of EU rules, but the Council was also thereby denied the opportunity to expose the work to wider competition from larger suppliers who may have been able to tender keener prices against a larger tender sum. At no point was the decision scrutinised nor subsequently did senior managers or Members question why the contract sum had been exceeded by such a large margin.

- 19** In relation to the shortlisting and evaluation of potential tenderers, there were serious shortcomings in relation to the arrangements in respect of the boiler replacement, doors/frames and UPVC windows contracts which totalled some £23 million. The tender specifications were ill-framed and decision-making was poorly evidenced. We noted a range of poor practice across these contracts.
- The selection of contractors from the select list to bid rather than the use of open tendering in relation to two of the contracts.
 - Contractors submitted prices on an inconsistent basis in relation to the doors and UPVC contracts as the tender specifications were inadequate in our view.
 - All of the tenders either underestimated or did not specify the likely work volumes of different work items and two included items where no work would be ordered. The schedule of rates for the £6.7 million doors contract included 132 items against which contractors were invited to quote prices but the tender evaluation focused on only the prices submitted against six of these items.
 - The approach to tender evaluation was ill evidenced and not robust, in our view, which made it difficult, particularly, for unsuccessful tenderers to understand or question how the results had been derived.
 - Individual officers were involved throughout the whole tender specification and evaluation process, included tender opening.
- 20** In relation to the above contracts, the working practices outlined, provided few effective controls to mitigate against the risk of collusion or corruption. Our investigation did not uncover any examples of collusion or corruption.
- 21** Financial assessment is also a fundamental control which aims to secure objective and independent evidence about the financial standing of tenderers. Whilst financial assessments were carried out professionally by finance staff, we found that the results of the assessments were not properly taken into account when deciding to award contracts in a number of cases. One contractor, with a financial assessment limit of £1.1 million has carried out work totalling £13.6 million in a single year. This was not subject to any management oversight or review. In relation to the boiler contract, the work awarded, also exceeded the assessed financial limits of the successful contractors. Although the contractors did not subsequently experience financial problems, the control did not function properly.

Value for money

- 22** The Council is unable to demonstrate that it has achieved best value in relation to the contracts described in the previous section. Whilst it is difficult to establish whether this resulted in additional cost to the Council, the Council's tendering and contract management procedures, neither promoted competition, to ensure prices were keen, nor assured that value was delivered.

Contract management

- 23 Contract management procedures are designed to ensure that the contractor delivers the required work satisfactorily, to budget and in accordance with the terms of the contract. We have noted serious failings in the Council's contract management procedures in relation to some of the major contracts which we examined.
- 24 The Council gains assurance that work has been delivered to the required standard and cost, principally through inspection. Inspection procedures in some areas of work, however, have been seriously inadequate. In relation to the UPVC 'backlog' contract, contract certificates totalling £6 million were approved but evidence of inspections undertaken was poor. Indeed in March 2006 the last contract certificate for £0.5 million was paid with no inspection of work undertaken.
- 25 We noted instances of bills being paid where no work had taken place, based upon sample audit inspections. One contractor, following our initial investigations in August 2006, paid back £130,000 to the Council in respect of invoices submitted for door installation where no work had in fact been carried out at all. This represented some 3 per cent of the doors fitted during the 12 month period.

Corporate and local arrangements

- 26 Whilst we consider that Technical Services was principally culpable for the failings outlined in this report, the magnitude of the problems was such, that corporate arrangements or long-stop controls ought to have been in place to identify issues as they arose to stimulate corrective action. In particular, there was inadequate corporate oversight of tendering and contracting arrangements in relation to housing repairs/improvements. Weaknesses in the corporate management of procurement and in the enforcement of contract procedure rules were evident in many areas; but in particular:
- members had little detailed knowledge of contract conduct and outcomes and have little involvement in tender opening, a key control to combat fraud and corruption;
 - there was little effective reporting to Members and senior management on contract expenditure or the levels of work awarded to individual contractors;
 - compliance with contract procedure rules were not monitored corporately;
 - the roles and responsibilities enshrined in contract procedure rules and the corporate procurement framework were inconsistent;
 - the remit of the corporate procurement team was confined to guidance alone rather than the professional leadership and supervision which is required; and
 - Legal services ensured legal compliance in relations to contracts it handled but was not consulted on the contracts whose cumulative spend breached EU limits.

- 27 The Council has been improving its corporate procurement arrangements throughout the period reviewed and it is now seeking to address the problems outlined above through a Council-wide Contract Management Improvement Plan.
- 28 An underlying thread to the problems we noted, was the Council's strong culture of delegation. Delegation can be a strong driver to empower local managers but needs to operate within an environment of effective corporate controls. In this context, the corporate focus had been on the delivery of the DHS programme which was, and remains, broadly on track. But this was not accompanied by an adequate focus on basic governance in relation to contract tendering and management. Too much autonomy was granted to local managers and this was not sufficiently balanced by compensating check or monitoring mechanisms.
- 29 The lack of corporate oversight was best illustrated, in this context, in relation to contract overruns and corporate reporting. The three contracts we examined exceeded their original contract sums by £19 million. In our view it is likely that the total overrun against original contract values, for all housing contracts, considerably exceeded £19 million but this is difficult to establish as the Council did not maintain an overall record comparing actual spend against original contract values. The only available summary information, a memorandum contracts register, maintained for other purposes, records that of the 51 contracts for repairs and improvements active in 2006, the cumulative overrun on 25 of these contracts amounted to £44 million. But we know that this record contains inaccuracies. Whatever the precise figure, it is clear the Council should have had mechanisms in place corporately, to challenge contract overruns to establish the reasons for the overrun and to propose corrective action where appropriate. It is not clear however that senior members or managers were aware of these contract overruns.
- 30 Overruns were due to a number of factors. In relation to the contracts we examined, the overruns arose as a result of Technical Services officers allowing contracts to enter lengthy extension periods. Whilst the use of lengthy contracts in these instances, was within the Council's discretion, the practice was relied upon unduly and applied outside of the intended context. It was also accompanied by a failure to review performance under contract procedure rules and to assess contemporaneously the continuing appropriateness and legality of the contractual arrangements. In short, small contracts, in these cases, became large contracts without being exposed, in the interim, to any renewed competition. The extension of a contract in these cases resulted in the Council making additional payments in excess of the original contract sum. Whilst the additional payments or contract 'overruns' did not constitute overspending per se, the Council cannot demonstrate that these contracts achieved best value, as they were not exposed to further competition; nor were the Council's management systems sufficiently robust to establish whether any overspending occurred or not.

- 31** There was also a lack of scrutiny and challenge by senior management and Members. In part this was due to the narrow remit of corporate departments in this regard. The role of Corporate Procurement was confined to guidance rather than to intervention, whilst no-one in any corporate department was involved in monitoring spend against contract values. Hence no-one was asking why contract values were regularly exceeded.
- 32** Legal services was responsible for signing off a number of housing repairs contracts but the Council's corporate framework sees the primary responsibility for detecting illegality and malpractice as resting with corporate directors, in this case the Corporate Director of Housing and the nominated Procuring Officer. The failure, for instance to identify breaches of EU competition rules may have been due in part to the responsibility for scrutiny falling between two stools. The view of Legal Services is that it could only challenge what it was aware of and that the Council's overall arrangements did not guarantee their involvement in all cases, particularly contract extensions. Whatever the cause, controls were not sufficient to provide an effective bulwark against breaches of regulations and non-compliance.
- 33** Responsibility for managing the Technical Services division and its procurement processes lay with the relevant Service Director. The latter was terminally ill during the period covered by our investigation and sadly died before the audit investigation commenced. This may have impacted on the operation of his division. But the Director of Housing also had a key accountability for delivering effective and compliant services.
- 34** The failures in strategic reporting arrangements are best illustrated by the fact that Members did not know, and therefore had no opportunity to challenge, that one contractor, who had been financially approved to carry out work only up to a £1.1 million limit, had been awarded work in excess of £16 million. This represented a significant proportion of all the contract work being carried out by the Housing department. The firm's work had increased to this level in only a few years.
- 35** In conclusion, whilst the failings described here were principally the responsibility of Technical Services, corporate management controls failed to identify and address the emerging problems. As a result the Council is not able to demonstrate that it has secured value for money in relation to the contracts examined nor that it has let and managed all of the associated contracts in compliance with contract standing orders and EU rules. A less visible consequence has been the erosion of the structures of management and control which underpin good governance. This has exposed the Council to the risk of fraud and corruption. Whilst our work has not identified any instances of fraud or corruption, the poor management controls in place did little to mitigate against such improprieties occurring.
- 36** We recognise that the Council has made improvements since the events described above and particularly in relation to our strategic recommendations outlined overleaf.

Strategic recommendations

- 37** We include here, strategic recommendations to assist the Council. More detailed operational recommendations are made in our detailed report.
- 38** Members should have a more active oversight of the procurement process to ensure officers are held to account. They should:
- approve annual procurement plans for services;
 - give final approval to entering into major contracts;
 - be involved in decisions about the procurement policy and the developing framework of procurement methodologies; and
 - receive reports on: value achieved; compliance with contract procedures/statutory requirements and the effectiveness of internal control.
- 39** The Council has indicated that it accepts the strategic recommendations and has been implementing changes in line with the recommended actions in response to the emerging findings from our work. Members have approved a Council-wide Improvement Plan to deal with the gaps in its arrangements and this is currently being implemented by a corporate group, led by the Service Director (Legal Services). The plan has the following main themes.
- Tightening control.
 - Training and accreditation.
 - Improving guidance and rules.
 - Improving management systems and monitoring.
 - Improving the contracts register system.
- 40** The Housing Department (now Adults and Housing) has also taken steps to strengthen its local controls, including the creation of dedicated posts for contract procurement and oversight.
- 41** It is important that the Council builds on the positive actions it has taken to maintain impetus. We therefore recommend that a further report is made to Members within six months of the issue of the report, setting out progress made in implementing the Council-wide Improvement Plan and describing which changes have become embedded and which remain to be implemented.