

Report in the public interest under section 8 of the Audit Commission Act 1998

Scarborough Borough
Council

Coastal protection schemes

PAGES 2 - 3

Summary

PAGES 4 - 18

Detailed Report

- Coastal protection schemes
- Legal framework
- Castle Headland scheme
- Coastal protection schemes prior to 2001
- Governance arrangements
- The way forward

Reference:	SC003 Report in the public interest under Section 8 of the Audit Commission Act 1998
Date:	December 2004

Introduction

I am the auditor appointed by the Audit Commission under Part II of the Audit Commission Act 1998 (the 1998 Act) to audit the accounts of Scarborough Borough Council. Section 8 of the 1998 Act requires me to consider whether, in the public interest, I should report on any matter coming to my notice in the course of the audit in order for it to be considered by the body concerned or brought to the attention of the public. This is an immediate report. In relation to several coastal protection schemes there is a compelling case for bringing to the attention of the public what I consider to be significant shortcomings in the way the Council managed the projects and failed to fully protect the interests of local and national taxpayers. The Council should consider the issues raised and the recommendations I have made.

This report examines in detail the management of the major Castle Headland Cliff Stabilisation scheme and other coastal protection work carried out since 1997 concentrating on the procurement of consultancy support and the role of key officers.

Overall conclusions

The Castle Headland scheme started in March 2002 and involves major civil engineering work to improve 2.1km of sea defences along Marine Drive in Scarborough. The key officer appointed to manage the scheme acted either in ignorance or disregard of procurement regulations and the Council's constitution. Other key officers, despite being made aware of these deficiencies failed to discharge fully their statutory responsibilities.

Approved spending for the scheme started at £28.6 million. The contractor is now claiming over £40 million which would be a very significant increase but has not been accepted by the Council. The construction contract was awarded after competition and the tender price fixed upon the basis of a specification prepared by the Council's consultants High-Point Rendel (HPR). Changes in the construction work, and therefore the contract price, followed variations relating to the identification of differing ground conditions to those assumed by HPR.

HPR who were the initial advisors for the project were awarded the role of supervisors for the construction phase of the scheme without any competition. As supervisors HPR are responsible for assessing claims for extra payments under the contract and determining liability for costs. Current estimates suggest the total supervision fee payable to HPR will be around £2.4 million. In my view proper practices were not followed in acquiring these services because procurement regulations and the Council's own constitution were not followed. The Council is therefore unable to demonstrate through market competition value for money in using these resources.

Inadequate arrangements in awarding the key functions of adviser and supervisor for the scheme make it difficult to determine whether the Council has overpaid for the work carried out. Following my comments in the 2002/03 Annual Letter the Council expanded the instructions to their specialist construction lawyers Watson Burton to review aspects of the scheme. The reasons for the increase in construction costs have so far been corroborated by Watson Burton.

While Watson Burton have assured the Council in respect of the construction work the governance arrangements exposed by the failure to comply with statutory requirements in appointing HPR fall far short of the standards the public have a right to expect. In my view the adequacy of the appointment process, the specification and the terms agreed with HPR were not sufficiently robust to protect the interests of the Council and local and national taxpayers. A bogus 'best value evaluation' exercise was prepared by an officer to justify the award of work to HPR. Procurement regulations were not complied with and in my opinion the appointment was unfair and unlawful. Further, the Council failed to secure best value in dealing with HPR as subsequent advice obtained by the Council suggests that payment terms transferred to the taxpayer the risks involved in delays in supervising complex engineering work.

I am informed that HPR decided that a detailed survey of the site was not required. Whilst this would have been expensive and may not have provided sufficient detail to eliminate design and cost uncertainties, it may have resulted in more reliable financial forecasts. Officers reported to Members the detailed conclusions reached by HPR and made available to them the full report but Members and DEFRA were not made aware of the potential implications of not undertaking a detailed ground survey. The initial estimate for supervision costs was £1.2 million but this has now doubled to £2.4 million. The payments made to HPR reflect the amount of time the consultants spent on supervision, and the increase in cost is substantially due to the extension of the contract period by 12 months.

Expenditure exceeding the budget for the Castle Headland scheme prompted our initial work. Our subsequent concerns about the way in which the Council awarded work to HPR led to joint work by us and Internal Audit in analysing previous coastal protection projects. We found that the Council has let other contracts to HPR in contravention of procurement regulations and its own Constitution. As such the terms and conditions of DEFRA grant have not been met and there is a risk of the Council now having to finance the advice and supervision costs. The failure to enter into a lawful and fair contractual relationship with HPR has exposed the Council to the unnecessary risk of financial loss and poor value for money.

Recommendations

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| R1 | Introduce procedures to ensure compliance with procurement regulations and the Council's own tendering rules. |
| R2 | Ensure legal and financial advice is sought to assess risks before entering into contractual arrangements so that mitigating controls can be put in place. |
| R3 | Appoint professional advisers through a competitive process. |
| R4 | Improve the quality of reports to Members to ensure balanced and full information is presented. |
| R5 | Ensure statutory officers are able to discharge their roles effectively. |
| R6 | Where non-compliance with regulations and procedures is identified, agree prompt action to address weaknesses. |

Coastal protection schemes

1. The Council has carried out a series of studies and improvements relating to coastal defences after the cliff failure and collapse of the Holbeck Hotel in Scarborough's South Bay in 1993. The planning and supervision work for many of these schemes was carried out by the Council's advisor High-Point Rendell (HPR).
2. The schemes attracted significant grant support from the government (via DEFRA and its predecessor MAFF) and Exhibit 1 includes the major schemes. Conditions of grant funding require the Council to follow statutory procurement requirements and internal rules set out in the Council's constitution.

EXHIBIT 1: MAJOR COASTAL PROTECTION SCHEMES

Scheme	Date	Construction £m	Planning & Supervision £m	Total £m	Actual/ Estimate
Holbeck to Scalby Mills Strategy	1997	N/A	0.4	0.4	Actual
Runswick Bay	1998	2.1	0.3	2.4	Actual
Whitby to Sands-end Strategy	1999	N/A	0.3	0.3	Actual
Robin Hoods Bay	2000	3.2	0.5	3.7	Actual
Haggerlythe	2000	1.8	0.1	1.9	Actual
Castle Headland Preliminary	2000	N/A	0.7	0.7	Actual
Holbeck-Scalby Mills Strategy	2000	N/A	0.1	0.1	Actual
Staithe Harbour	2001	2.9	0.3	3.2	Estimate
Castle Headland Main Scheme	2002	37.9	2.4	40.3	Estimate
Total Cost		47.9	5.1	53.0	

3. The most recent project, the 'Castle Headland scheme', involves major civil engineering work to improve 2.1km of sea defences along Marine Drive in Scarborough. On the 6 March 2002 DEFRA approved spending to the value of £28.6 million (75 per cent by direct grant and 25 per cent by Supplementary Credit Approval (SCA)). The scheme is technically complex, involving the construction of armoured revetments and sinking a large number of reinforced concrete piles bored into the sea bed and on land immediately next to the sea wall.

Legal framework

4. The framework for decision making by the Council is governed by the regulations and principles set out in:
 - European Community (EC) procurement rules;
 - the Council's constitution which sets out Contract Procedure Rules; and
 - the terms and conditions of government grants awarded by DEFRA for coastal protection schemes.

EC procurement rules

5. The EC Public Procurement Directive was given effect by UK legislation in the Public Services Contract Regulations 1993, Public Works Contract Regulations 1991 and Public Supply Contract Regulations 1995 to ensure fairness and openness in the appointment of contractors. The regulations require all local councils to advertise work Europe wide in the Official Journal of the EU (OJEU – previously known as OJEC) when the value is above limits which are updated every two years and are currently £154,477 for services such as consultancy or contract supervision and £3,861,932 for construction. When public bodies fail to advertise the work in this way and then award the contract without exposing the contract to competition they operate unlawfully and face the risk of litigation from other potential bidders denied the opportunity to bid for work which if successful can lead to the award of damages against the contracting authority.

Constitution – contract procedure rules

6. The Council's Procedure Rules set out general responsibilities that require Directors to:
 - seek best value;
 - show no undue favour to any contractor;
 - do nothing that contravenes EU or domestic Law; and
 - ensure adequate contract files are kept for all contracts.
7. Section 24 of the Contract Procedure Rules sets out circumstances when tendering requirements can be waived including (e) 'contracts with specialist persons'. Although not specifically stated in the Contract Procedure Rules this is subject to following EU and domestic law.
8. Section 31 of the constitution summarises negotiation rules and paragraph 31.5 requires negotiations on contracts above £100,000 or more to be reported to the cabinet for information. Section 34 also requires the approval of the Head of Legal Services for contracts above £25,000 which should then be signed by two of the following authorised officers:
 - the Chief Executive;
 - the Head of Legal Services; and
 - the Property and Contracts solicitor.

9. The Council defines a key decision as one where the sum involved is over 1% of the approved Council budget. The Council's 'Principles of Decision Making' are set out in Article 13 of the Constitution and include:
 - decisions should be taken on the basis of due consideration and the professional advice of officers;
 - a presumption of openness; and
 - explaining options considered and giving reasons.
10. It is important that the Council should follow the rules set out in its own constitution to avoid unnecessary risk.

Grant terms and conditions

11. Grant terms and conditions under the Coastal Protection Act 1949 are set out in a MAFF (Now DEFRA) Memorandum of March 1998. The following are key terms.
 - Para 42 stipulates that EC procurement should be followed.
 - Para 45 requires that prior agreement [of DEFRA] should be obtained in writing if it is proposed to waive the requirements for competitive tendering.
 - Para 50 states that Consultancy contracts should be 'fair and open'.

Failure to follow the grant terms and conditions could result in a loss of grant income.

Castle Headland scheme

12. Our work on the main Castle Headland has concluded that the Council's procurement arrangements were significantly deficient. Serious shortcomings include:
- the supervision element of the work carried out by HPR valued at £1.2 million was not advertised in OJEC, failed to meet EC procurement requirements and did not follow the Council's internal regulations. It was therefore awarded unfairly and unlawfully;
 - the Council, having failed to follow EC procurement requirements and its own constitution, risks losing grant and loan support for HPR's advice and supervision work for the preliminary scheme (0.7 million) and contract supervision (£2.4 million). The extent to which DEFRA may challenge the grant and loan support is uncertain, bearing in mind that if the consultancy work had been tendered for properly, fees for this work would have had to be paid;
 - the financial risks of not carrying out a full survey on the site were not communicated clearly to Members or to DEFRA. A detailed report was prepared by HPR and the Director of Technical Services included the executive summary of this report in his summary in his report to Cabinet on 6 April 2001 but this did not provide a detailed analysis of the pros and cons of carrying out a full survey of the site. This analysis was only carried out by HPR later and set out in a report prepared in June 2003; and
 - The approach adopted in engaging HPR failed to follow best value principles and did not involve legal approval as required by the Council's constitution. While an increase in fees was always likely when difficulties with the main contract were encountered, all of the additional costs of supervision fell on the tax payer with the fee increasing from £1.2 million to an estimated £2.4 million.

Background

13. In February 2000 an application was made for DEFRA funding to consider the strategy for the Holbeck and Scalby Mills coastline. The project involved the Council's advisors, HPR:
- drawing up the strategy;
 - liaising with other specialists in wave test modelling;
- and subsequently involved instruction to
- draw up the specification for the main scheme;
 - evaluate the bids from contractors for the project.
14. The fees for the initial work were estimated at £246,000 in the application to DEFRA. The actual cost, including the subsequent instructions, was £669,000 and the increase reflects the significant underestimate by HPR of the input time needed to:
- contribute to the wave modelling study;
 - prepare the environmental statement; and
 - advise on the standard of repairs needed on the grade 2 listed East Pier.

15. The Council did not negotiate a cap on fees and the risk of underestimating the project time fell on the Council and the tax payer. A full site survey was not carried out. According to the Council's Capital, Strategy & Procurement Manager, HPR used local knowledge as a basis for predicting ground conditions as expensive specialist plant would have been required to carry out this work. This is understandable and according to officers it is likely that if a cost benefit analysis of a full survey was considered then it would have been ruled out in any case. The decision not to undertake a survey however, increased the risk of scheme overspend but this was not made clear to DEFRA or to Members.
16. Following advice from HPR the tendering exercise for the construction element was advertised in OJEC. The fee for supervision work was expected to be £1.2 million which is above the threshold but EC procurement rules and the Council's own constitution were not followed for this element of the scheme.
17. On the 6 March 2002 DEFRA approved spending of £28.6 million on the scheme on the basis that the Council's own procedures and statutory requirements would be met. The components of the approval were:
- construction works £25.7 million;
 - consultants fee £1.4 million;
 - 5 per cent contingency £1.3 million; and
 - other £0.2 million.
18. Work on the scheme started quickly after formal DEFRA approval because of the exposed nature of the cliff. Significant winter working was not feasible so work needed to start as early as possible to take advantage of summer conditions. Key dates are summarised in Exhibit 2.

EXHIBIT 2: KEY DATES

2 November 2001	Letter sent to DEFRA with provisional costs of the scheme, supervision £1.4 million.
20 November 2001	The Capital, Strategy & Procurement Manager requests HPR to provide a detailed costed proposal for the supervision work.
17 December 2001	Final funding request submitted to DEFRA by SBC.
19 December 2001	HPR advertise for on-site staff.
22 February 2002	Members informed of the outcome of the tendering process for the main contractor and negotiations were ongoing with HPR.
25 February 2002	The Council's Contract Lawyer requested details of the contracts from Capital, Strategy & Procurement Manager having noticed an article in the Scarborough Evening News.
6 March 2002	DEFRA funding confirmed supervision costs of £1.4 million.
8 March 2002	Capital, Strategy & Procurement Manager gives approval 'in principle' to HPR's fee proposal of £1.2 million.
8 March 2002	Capital, Strategy & Procurement Manager passes the fee proposal and draft contract to the Council's contracts lawyer.
Mid March 2002	HPR supervision staff begin to set up their site establishment.
19 March 2002	Contracts Lawyer expresses concerns that there was no cap on fees.

8-20 March 2002	Best Value Evaluation Exercise drafted by the Capital, Strategy & Procurement Manager to justify choice of HPR and subsequently forwarded to DEFRA when confirming appointment of HPR.
20 March 2002	Pre start meeting held in Scarborough involving Council staff HPR and the Contractor.

19. When piling of the toe support started it quickly became apparent that the proposed solution was unable to deal with the very variable ground conditions. By October 2002 it was clear that there would be a significant overspend of at least £7.5 million because different ground conditions to those assumed by HPR were identified. In a report to cabinet the Director of Technical Services reported that it would be prudent to build £47 million into the capital budget to reflect a forecast overspend of up to £18.6 million. Negotiations as to the final price have yet to be concluded.
20. Of the overspend £1.2 million for HPR reflects the consequential extra supervisory time to deal with a significant number of complex 'compensation events', ie, claims for additional costs, submitted by Edmund Nuttall (EN) the contractor. These events identify additional work which was not predicted in the scheme specification.

Engagement of HPR

21. In a letter dated 20 November 2001 to HPR the Capital, Strategy & Procurement Manager wrote:

EXHIBIT 3: EXCERPTS OF THE LETTER TO HPR 20 NOVEMBER 2001

In order to formally engage you for the next stage of the scheme it will be necessary for you to provide a fully costed and detailed proposal. This will clearly need to demonstrate competitiveness and indeed any preferential terms you propose to offer to the Council given the likelihood that it will not be subject to a separate tender process

In the spirit of partnership I would therefore be pleased to receive from you your fee proposal to include a breakdown of staff to be employed, hourly rates, details relating to overhead/profit.

Copy Letter

22. HPR sent a draft copy of their proposed fees and charges to the Council around mid January 2002 and set out a fee charging scale which was mainly on a variable basis depending upon HPR's time input to the scheme. The terms of HPR's work were accepted by the Capital, Strategy & Procurement Manager and after receipt of funding confirmation from DEFRA on 8 March, the Capital, Strategy & Procurement Manager wrote to HPR without seeking legal advice or Council approval to say:

EXHIBIT 4: EXCERPT OF THE LETTER TO HPR 8 MARCH 2002

I confirm my approval, in principle to your proposals and on the basis of the details included would authorise you to proceed to set up the site supervision team.

Copy Letter

23. The approach adopted by the Capital, Strategy & Procurement Manager in respect of legal advice was reactive. He did not routinely involve legal officers unless the Head of Legal Services (the Monitoring Officer) challenged or requested information as part of his scrutiny of cabinet or Chief Officer Group reports. As many of the reports to Members relating to HPR omitted detail of the procurement method and the contract value it was difficult for the Monitoring Officer to do this.

24. The Council's Contract Lawyer wrote to the Capital, Strategy & Procurement Manager requesting sight of the contract on the 25 February having noticed that a substantial contract was about to be let in an article in the local press. After this request and on the same day (March 8) as sending the letter of intent to HPR, the Capital, Strategy & Procurement Manager passed details to the Contract Lawyer. The Council's Contract Procedure rules (34.1b) require contracts of £25,000 or more to be approved by the Monitoring Officer; given the plans already made this was not possible before commencement of the work.
25. The Council's contract lawyer responded on 19 March 2002 having identified the following issues:
- the variable nature of the fee for HPR;
 - the failure to adhere to the Council's contract procedure rules; and
 - the commencement of work before the contract was agreed.
26. The Contract Lawyer wrote in August 2002 to the Monitoring Officer, the Director of Corporate Services and the Director of Technical Services setting out her concerns in respect of the terms of the contract with HPR and pointing out the absence of any limit on the cost to the Council given the charge rate applied. Despite this and previous correspondence the Capital, Strategy & Procurement Manager subsequently agreed an increase in fees in November 2002 to supervise the 'compensation events' referred to in claims to vary scheme costs received from the contractor.
27. When asked to comment in October 2002 the Council's construction lawyers Watson Burton described the terms as follows.
- *All the risk of additional cost is allocated to Scarborough Borough Council (SBC), there is no risk sharing in this arrangement.*
 - *The rates used are very confusing [with] figures given both hourly and monthly, monthly are much more expensive than the hourly rates.*
 - *There is no incentive on HPR to find added value, to control their costs expenditure or to act in a prudent way. In effect they have been handed a blank cheque to charge SBC every element of cost, however inefficient, duplicated, wasteful or unproductive.*
28. The nature of coastal protection schemes makes it difficult to accurately predict costs and I note most of the major schemes carried out by the Council have cost more than originally predicted both for construction and supervision work. Both the Capital, Strategy & Procurement Manager and HPR were aware of the potential working practices that could be employed by each potential contractor as references were obtained to inform the bid evaluation process. In my opinion this contextual information meant that paying HPR's costs on an input basis was likely to lead to fee escalation. Following advice from Watson Burton in October 2002, new terms were added but it was not until January 2004 that draft contract terms were sent to HPR. There were two reasons given for the delay:
- HPR had been working on the scheme since March 2002 and paid at the rates accepted in the Capital, Strategy & Procurement Manager's letter of intent. Watson Burton indicated that given the on-going status of the work it would not be practical to make significant changes to the terms. Legal resources were stretched in late 2002 and 2003 and the work of finalising the contract was not given the highest priority; and
 - difficulty in finalising contract arbitration arrangements.

29. At the time of writing, a signed contract has still not been returned from HPR so there is no authorised contract as required by the Contract Procedure Rules. It is clear that the Council's processes in engaging HPR were seriously deficient. In addition despite internal and external advice relating to the need to strengthen the contract the Council has been slow to respond and seek a renegotiated arrangement.

Evaluation of HPR

30. The Capital, Strategy & Procurement Manager referred Internal Audit to a 'best value evaluation exercise' as justification for awarding the work to HPR. The summary report setting out the conclusions of this exercise was subsequently sent to DEFRA and the main conclusion of the exercise is that HPR's involvement in setting up and designing the scheme meant it was logical for them to continue their involvement and supervise the construction work. In my view this exercise was undertaken retrospectively to justify the decision to award work to HPR rather than appraise options or seriously challenge their proposals as:
- no advice was taken from finance or legal staff;
 - there was no effective comparison with other advisors in the evaluation, the only comparison was made with hypothetical organisations;
 - the technical evaluation was based on the CIRIA model but this is designed for use evaluating competitive quotes;
 - HPR helped in the production of the evaluation; and
 - the Council's approved tenders list for marine survey work included other firms but these potential comparator organisations were ignored.
31. In the conclusion of the summary report the Capital, Strategy & Procurement Manager apparently aware of the EC procurement requirement stated that:
- 'it is expedient to engage HPR in accordance with the proposal, notwithstanding that the value exceeds thresholds set by European Directives'.*
32. The Council, having failed to follow EC procurement requirements and its own constitution, and having carried out an inadequate best value evaluation exercise, risks losing grant and loan support toward HPR's supervision work now expected to cost in excess £3.1 million including the preliminary scheme. In my view, because work was awarded to HPR unfairly and unlawfully, the Council has not adequately managed the fundamental financial risk present in this major project.

Coastal protection schemes prior to 2001

33. Given the problems identified in the Castle Headland project we examined the other recent coastal protection schemes and found the Council's arrangements were not adequate as:
- the award of work to HPR for supervision work on four of the schemes to a value of £1.8 million did not follow EC procurement requirements; and
 - there were no signed contracts for six of the HPR schemes to a value of £2.2 million contravening Contract Procedure Rules.

Procurement of HPR for pre 2001 schemes

34. The Council's advisors HPR have both a long and close working relationship with the Council going back to 1987. HPR are considered by the Council and DEFRA to be experts on the particular soft rock geology found at Scarborough. HPR also were commissioned by DEFRA to produce a national report 'Investigation and Management of Soft Rock Cliffs' published in 2002.
35. Exhibit 5 shows major HPR Schemes 1997-2001.

EXHIBIT 5: COASTAL PROTECTION SCHEMES HPR (INCLUDING SUB-CONTRACTING)

Scheme	Date		Estimate Total £000	Actual Total £000	Variance £000
Holbeck to Scalby Mills Strategy	1997	Strategy	369	446	77
Runswick Bay Emergency Work	1998	Supervision	335	335	
Whitby to Sands-end Strategy	1999	Strategy	259	318	59
Robin Hoods Bay & The Haggerlythe	2000	Supervision	150	487	337
Castle Headland Preliminary	2000	Specification Wave Modelling	246	639	393
Holbeck-Scalby Mills Strategy	2000	Strategy	132	132	
Staithes Harbour	2001	Supervision	286	286	
Major Schemes			1,777	2,643	866

36. In general the approach adopted was to tender for an initial study or scoping exercise often involving less than £50,000. Thereafter the consultant (in these cases HPR) were commissioned to develop the scheme into a major project often involving:
- preparing a strategy;
 - drawing up the scheme specification; and
 - supervision of the contract.

37. The value of the consulting/supervision work tended to increase significantly as the schemes progressed. For example HPR won a tender for the work at Staithes in 1997 for work initially valued at £104,000. As the value of this initial work was below the EC procurement threshold there was no need to OJEC advertise the work. HPR helped design the work and were then awarded the supervision work in 2001 on that basis and that they were the local experts. The supervision work (an additional £286,000 listed on exhibit 5) exceeded the EC procurement threshold, an advertisement should have been placed in OJEC.
38. Contracts for the work were let on a piecemeal basis usually after funding had been agreed (subject to adherence of the grant terms) by MAFF/DEFRA the grant paying department. As the contracts were let on this basis each required compliance with EC procurement requirements, the constitution and grant terms described above. Although aware later, at the time the Capital, Strategy & Procurement Manager responsible for all aspects including setting up and managing the schemes on behalf of the Council has said he was unaware of the EC procurement threshold.

EC Procurement Rules supervision contracts

39. The following four HPR schemes to a value of £1.8 million exceeded EC procurement thresholds, should have been advertised in the OJEC and the work was therefore awarded unlawfully:
- Holbeck to Scalby Mills Coastal Defence Strategy £446,000;
 - Robin Hoods Bay and Haggerlythe Supervision £487,000;
 - Castle Headland Preliminary scheme and the sub-contracted work £639,000; and
 - Staithes Harbour £286,000.
40. Of the other major schemes:
- the work at Runswick bay was carried out under emergency powers; and
 - the Whitby to Sandsend strategy HPR's fee was initially expected to total £344,000 but this was split between HPR (£120,000) and a number of sub-contractors each element was below the EC procurement threshold. The scheme however significantly exceeded the original budget and, with additional work, HPR were paid £252,000, well in excess of the procurement threshold.

Contract Procedure Rules

41. The Council's Contract procedure rules require a contract to be reviewed and signed by authorised officers. Of the schemes referred to in Exhibit 5 there was a properly signed contract only for the first scheme Holbeck to Scalby Mills costing £446,000. For the remaining six schemes valued at £2.2 million there was no contract documentation and the Head of Legal Services did not review the payment terms so the requirements of the Council's Contract Procedure Rules were not met.

Governance arrangements

42. The Borough Council, in common with other local authorities, has adopted rules and regulations to govern its decisions in order to comply with legislation and safeguarded its financial position. In considering the evidence reported earlier it is clear that some governance arrangements have not been effective. There have been failings in obtaining and reporting sufficient evidence to demonstrate rules and regulations have been complied with or areas where internal procedures have not been adequate. I consider there is scope to improve openness and accountability and in particular I have identified weaknesses in arrangements in respect of:
- the role of the Director of Technical Services;
 - the provision of legal advice;
 - the role of the Monitoring Officer; and
 - the role of the s151 Officer.

The role of the Director of Technical Services

43. The director responsible for coastal protection schemes was the Director of Technical Services until he left the Council in August 2003. With a large department and no previous experience of engineering services, the Director relied on the specialist advice of his supporting officers for coastal defence projects. This involved those working in the Capital Strategy and Procurement Unit. As project manager for the Castle Headland Scheme, the Capital Strategy and Procurement Manager reported directly to the Director of Technical Services, and subsequently, the Chief Executive after August 2003. The project manager's role, largely full time, covered all aspects of the day to day management of the scheme, including liaison with the contractor, the supervisor and Members, including drafting key cabinet reports.
44. Members have informed me that they expected the Director to have satisfied himself as to the quality and completeness of reports issued in his name and to have taken action if he was aware of activity that was potentially unlawful. The Capital Strategy and Procurement Manager has stated that in late 2001 the Director knew of the intention to roll forward the HPR contract but he did not instruct the Capital Strategy and Procurement Manager to put the work out to competition. The Director has informed me he was not aware of the competition requirements for advice and supervision works as he had no experience of working within the relevant regulations and this matter was not brought to his attention by the Capital Strategy and Procurement Manager on whom he was relying.
45. It is essential that Members receive adequate information to enable effective decision making and allow the progress of projects to be assessed. Article 13 of the Council's constitution applies to decisions on contracts with significant value and requires detailed information to be provided. It is important that the Council follows its own constitution in making decisions on procurement as the grant paying body DEFRA and its forerunner MAFF relied on this decision making process when approving each scheme. I have examined the reports used by Members as the basis of decisions in respect of coastal protection schemes. In my opinion the reports did not adequately clarify the risks associated with the actions proposed and in my view there are examples of reports:
- that contain information which could be misleading; and
 - that do not contain sufficient information on the supervision element of projects.

46. The 22 February 2002 report to Cabinet detailed by the Director of Technical Services the outcome of the tendering exercise for the construction element of the Castle Headland Scheme. The key sections of the report relevant to HPR are set out in Exhibit 7.

EXHIBIT 7: FEBRUARY 2002 REPORT TO CABINET

Para 2.1 Because of the scale and nature of the proposed works the procurement process has been a detailed and lengthy one involving reference to Economic Union Contract Procedure as well as the Council's own financial and Contract standing orders.

Para 3.5 In addition to the engagement of the preferred contractor negotiations have also been on-going with the Council's consultants, High-Point Rendel, to agree the terms for the engagement to supervise the works.

February 2002 report to Cabinet

47. This report followed a pattern seen in earlier reports with detailed information provided relating to the construction element but very little information provided on the supervision aspects of a scheme. Based on this report cabinet decided to accept the tender of Edmund Nuttall (EN) at £25.7 million and to engage HPR at £1.2 million to supervise the work. The report suggests that EU Contract Procedure was followed without making clear that this just applied to the appointment of the construction contractor. As the HPR element at £1.2 million constituted a key decision officers should have made Members aware that paragraph 2.1 only referred to the construction work and the information was therefore misleading.
48. In the following examples only limited information was given in reports by the Director of Technical services to Members in respect of HPR's supervision work.
- **Runswick Bay Emergency Works:** Details of the construction element of the scheme were reported in October 1998 valued at £2.7 million but no information was given to members on the cost of HPR's supervision work valued at £335,000 or the fact that the tendering procurement requirement was waived.
 - **Robin Hoods Bay/Haggerlythe:** Whilst detailed information was provided to members in November 1999 and February 2000 of the construction element of the scheme little was reported on supervision apart from the initial estimate of £150,000. No information was provided of the tendering waiver of the subsequent total supervision cost of the scheme at £487,000 or the £1 million overspend on construction.
 - **Castle Headland Preliminary Scheme:** No evidence has been seen of any detailed project report for this £639,000 scheme.
 - **Staites Harbour:** The total cost of the scheme at £3.24 million was reported to Members on 23 March 2001 with no detail of HPR's supervision arrangements valued at £286,000 or that tendering had been waived.

Provision of legal advice

49. Significant expenditure was involved with the coastal defence works arranged by the Council. Appropriate legal advice was therefore needed to ensure that risks were mitigated. However, there appears to have been inadequate legal input into the contractual and tender arrangements. In particular:
- legal advice on the proposed award of supervision work was not sought;

- the values for supervision work were not specified in reports to Members so the Monitoring Officer did not identify transactions where legal advice would be needed as required by the Council's Contract Procedure Rules; and
- work to the value of almost £5 million has been awarded but without a signed and sealed contract as required by the Council's constitution.

Monitoring Officer

50. The Council's Head of Legal Services was appointed as the Council's Monitoring Officer pursuant to Section 5 of the Local Government and Housing Act 1989. This places a duty on the post holder to report on any proposal, decision or omission, which appears to him to give rise to, or be likely to give rise to a contravention of any enactment, rule of law or code of practice. The Monitoring Officer role was added to the duties of the Head of Legal services in November 2001 following the death of the previous post-holder. This arrangement was made permanent in July 2002 without any additional support in Legal services and was during a period of significant workload.
51. At some point the Capital, Strategy & Procurement Manager was aware of the failure to comply with EC procurement relating to the supervision work but legal staff were not. The Monitoring Officer in post at the time and the Contracts Lawyer have both indicated that whilst they were aware of the failure to comply with Contract procedure rules they were unaware of the failure to follow EC procurement relating to HPR at the time.
52. On the 1 August 2002 the Contracts Lawyer wrote to the Monitoring Officer, the Director of Technical Services with copies to the Director of Corporate Services and Capital, Strategy & Procurement Manager. The letter identifies three breaches including one relating to HPR's supervision of the scheme. The Conclusion is summarised in Exhibit 8 below.

EXHIBIT 8: CONCLUSION OF 1 AUGUST 2002 E-MAIL

what a serious problem it is for the Council to be placed in a position where it is in breach of its own constitution and acting ultra vires. Under the circumstances, [the Monitoring Officer] has no choice but to deal with this matter in his formal capacity as Monitoring Officer

53. Despite this, no action was actually taken to investigate the tendering arrangements and no report to Members was issued. The Monitoring Officer should have been far more thorough and should have exercised his duty to investigate the possible legal consequences of the failure to properly observe the Council's own procedures. Had he exercised his duty it is likely that he would have also identified the way in which work was unfairly and unlawfully awarded to HPR. He could then have acted more robustly to safeguard the Council's interests by seeking further information and assessing whether corrective action was possible. He should also have exercised his reporting duty to Members.

S 151 Officer

54. The relevant provisions of Section 151 of the Local Government Act 1972 are stated in Exhibit 9 below.

EXHIBIT 9: SECTION 151 OF THE LOCAL GOVERNMENT ACT 1972

Every authority shall make arrangements for the proper administration of their financial affairs and shall ensure that one of their officers has responsibility for the administration of those affairs.

55. The Director of Corporate Services has this responsibility. In addition he is required by Section 114 of the Local Government Finance Act 1988 to report to the Council if a decision has been made or is about to be made which involves or would involve incurring expenditure which is unlawful, has taken or is about to take a course of action, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency on the part of the Council or is about to enter an item of account the entry of which is unlawful.
56. The Director of Corporate Services was aware of the failure to comply with Contract Procedure Rules as he was informed of this by the Contract Lawyer in August 2002. Further, by October 2002, the major overspend of up to £18.6 million was reported to Cabinet but no action was taken by the Director of Corporate Services to report to Members or challenge the management of the scheme. It may be that the scheme was considered to be low risk given the high level of government support but this ignores the possibility of the Council losing significant levels of grant by not properly following the terms and conditions.
57. I consider he should have been far more thorough and should have obtained more assurance about the possible financial consequences before the coastal protection schemes referred to earlier were allowed to proceed. I also consider that when he became aware there were issues in respect of the award of work to HPR he could have acted more robustly to safeguard the Council's interests by seeking further information and assessing whether corrective action was possible. He should also have exercised his reporting duty.

The way forward

58. This report identifies serious deficiencies in Council processes relating to many of the Council's coastal protection schemes. The schemes are funded almost entirely by DEFRA with Scarborough Borough Council being the accountable body. It is disappointing to note that the required standards of probity and good governance have not been applied in these instances and the Council is unable to adequately demonstrate it has secured value for money.
59. In November 2003 we reported to the Council our initial concerns in our Annual Letter. We recommended the Council needed to:
- regularise the arrangements for the contracts in respect of the supervision element of the scheme;
 - revise internal procedures to ensure compliance with EU procurement requirements;
 - ensure that minutes and agenda papers record the full background to decisions; and
 - evaluate the reasons for the additional costs relating to the scheme.
60. The Council has taken action to address risks which includes a review HPR's work in detail. Advice has been obtained from Watson Burton who have scrutinised compensating events agreed by HPR and have advised HPR on their approach to dealing with these events.
61. In September 2004 revised contract procedure rules were adopted by the Council that clarify the need to follow procurement regulations and in future the Council needs to ensure these rules are followed and the other specific weaknesses highlighted in this report are addressed.