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**DE INTERNAL AUDIT REVIEW
OF
SEELB MAINTENANCE
MTC INVOICES**

27th January 2011

SUMMARY

Following concerns highlighted in relation to the management of the South Eastern Education and Library Board's (SEELB) Measured Term Contracts (MTCs) for maintenance, the Department's Permanent Secretary tasked DE Internal Audit with reviewing the invoices paid to the current MTC contractors.

The purpose of the review was to determine if work had been properly allocated to the contractors in line with the contracts, correctly charged for and processed in accordance with sound internal control principles. The review team was alert to the possibility of fraud within this area in light of a previously identified suspected fraud relating to boiler replacements.

In addition, the Department engaged the Central Procurement Directorate (CPD) to provide an opinion on how the Electrical Maintenance MTC was operated including an assessment of the work undertaken and costs paid for a sample of orders.

ELECTRICAL MAINTENANCE MTC

Internal Audit carried out a 100% review of payments over £200 made to the contractor who holds the Electrical Maintenance MTC. The invoices included payments for planned maintenance through the MTC along with response maintenance jobs.

Electrical Maintenance MTC – Key Issues Identified

The key issues identified through the review are outlined below, however, Internal Audit would highlight that the practices undertaken varied between the different Mechanical and Electrical (M&E) Maintenance Officers (MOs) and not all the issues highlighted below related to all individuals.

- Lack of documentation to support the costs charged on the invoices (for example written quotations);
- Lack of knowledge by MOs of contract details and requirements;

- Significant reliance placed on the knowledge and directions of the Senior Maintenance Officer (SMO) resulting in an erosion of real segregation of duties;
- Limited evidence of control exercised over the use and costs of sub-contractors;
- Limited evidence of Board MO challenge of charges submitted by contractor in the invoices; and
- Significant proportion of dayworks (up to 76% in one case) charged to a significant number of jobs processed within MTC terms.

Electrical Maintenance MTC Evaluation

Internal Audit considers that the issues highlighted above represent serious internal control weaknesses and therefore provide an unacceptable level of assurance to the Accounting Officer. These weaknesses result in the Board being unable to demonstrate that fraud and loss were prevented and value for money achieved.

Internal Audit has sought advice on fraud risks from the Department of Agricultural and Rural Development's Central Investigation Services (CIS). CIS advised that the issues identified did not represent evidence to suspect fraud or criminal activity had been perpetrated by any individual or organisation. However, Internal Audit considers that, while no evidence of fraud was uncovered, these weaknesses have left the system vulnerable to error, fraud or exploitation.

BUILDING MAINTENANCE MTC

While there is only 1 MTC for electrical maintenance, there are 11 current MTCs for building maintenance across a range of disciplines. Internal Audit checked a sample of approximately 18% of the invoices over £200, including both MTC and response maintenance jobs. No significant issues were identified.

Internal Audit found that the rates charged were in accordance with the MTC terms. In addition, supporting documentation (for example, written

specifications, estimates, drawings and diagrams etc) was available. Internal Audit also found evidence of Building MOs checking and challenging the detail of the invoices, for example the measurement of the jobs.

Internal Audit considers that the review of Building Maintenance invoices indicated that the controls in this area were satisfactory and operating consistently.

1. INTRODUCTION

- 1.1 In light of concerns highlighted by the SEELB in relation to the operation of an MTC contract for maintenance, Internal Audit was tasked by the Department's Permanent Secretary with carrying out a review of the invoices paid in respect of the SEELB's Maintenance MTCs.

Work Undertaken by Internal Audit

- 1.2 A review of all invoices from the Electrical Maintenance MTC contractor, over £200, for the period May 2006 (the start of the MTC) to October 2010 was carried out. This included a significant number of invoices for emergency response maintenance. The purpose of this review was to:
- Determine all parties involved in initiating, approving and paying for works;
 - Determine if the invoices submitted were in accordance with the contract terms;
 - Determine if the procurement approach used in the award of contracts was appropriate.
- 1.3 Although payments in relation to the Electrical MTC were the initial priority, a sample of the invoices for the Building Maintenance MTCs was also reviewed using the same approach.

Review by Central Procurement Directorate (CPD)

- 1.4 The Department also engaged CPD to advise on technical aspects of the management of the Electrical Maintenance MTC and the works undertaken by the contractor. CPD were specifically asked to comment on or verify that:
- The extent of the work corresponded with the quantities set out in the measurement of the orders;
 - The price paid by the SEELB was satisfactory and in keeping with market prices; and

- The appropriateness (or otherwise) of the method of procurement of the works i.e. should the works have been procured using MTC or by another mechanism.

1.5 The CPD review was restricted to Electrical Maintenance as no significant issues were identified in relation to Building Maintenance.

Work Undertaken by CPD

1.6 CPD carried out a desk review of contract documentation including the detail of a sample of orders. Visits to a number of sites were undertaken to verify (as far as possible) that the installation was carried out as described in the documentation. An interview was held with the Electrical Maintenance MTC contractor to obtain further information and clarification.

Advice on Fraud Related Aspects

- 1.7 In light of a previously identified suspected fraud relating to boiler replacements, the Department was concerned that there could be potential for fraud within the operation of the MTCs.
- 1.8 To ensure that potentially fraudulent issues that may arise were properly considered and addressed, the Department engaged the CIS to provide advice on the risk of fraud within this area and review the potential for fraud within the emerging findings.

2. MTC FOR PLANNED ELECTRICAL MAINTENANCE/MINOR WORKS

Background to the MTC

- 2.1 The Electrical Maintenance MTC contract was awarded in May 2006 for an initial period of one financial year, renewable for a further two years dependent upon contractor performance.
- 2.2 The contract was for planned electrical maintenance and minor works with the minimum value of any one order set at £100 and the maximum order value limited to £15,000. It was estimated that the value of work under the contract would be approximately £150,000 per year.
- 2.3 The 2 year extension clause was activated in May 2007. Board officers have indicated that all such contracts automatically run into their extension period unless a problem with the contractor is reported.
- 2.4 In March 2009 the Commissioners approved an extension of the contract from 1st May 2009 – 31st December 2009 to coincide with the establishment of ESA. On 2nd September 2010, Board officers sought retrospective approval from the Commissioners to extend both the Electrical and Building MTCs until 31st December 2010 or until the commencement of the new MTC for maintenance (which was expected to be in place before December 2010). Extending the contract in this way is in effect a single tender action and as such would have required Accounting officer approval. Internal Audit understand that Accounting Officer approval was not obtained in this case.

Value of the Contract

- 2.5 The table below sets out the total value of payments made to the Electrical Maintenance MTC contractor since the date the MTC was established. This includes payments in respect of MTC orders along with

emergency response maintenance work as the contractor is also on the Board's select list for this type of work.

<u>Year</u>	<u>Number of Orders</u>	<u>Response Maintenance *</u>	<u>Other Works</u>	<u>Total</u>
2006/07	225	£49,571.10	£145,970.16	£195,541.26
2007/08	266	£62,246.46	£309,198.59	£371,445.05
2008/09	244	£73,678.32	£213,072.34	£286,750.66
2009/10	301	£60,550.11	£351,392.38	£411,942.49
2010 - 15/11/10	204	£39,471.91	£54,686.09	£94,158.00
	1240	£285517.90	£1,074,319.56	£1,359,837.46

* estimated based on order value and extracted from response maintenance contractor rotation report.

Detailed Findings

- 2.6 Through the review of invoices Internal Audit identified a range of internal control weaknesses relating to the management and control of the Electrical Maintenance MTC. The key issues identified are outlined in the paragraphs below, however, Internal Audit would highlight that the practices undertaken varied between the different Mechanical and Electrical (M&E) Maintenance Officers (MOs) and not all the issues highlighted below related to all individuals.

Management of the Contract

- 2.7 As part of their review, CPD identified that the MTC does not appear to be operated as written. When the Board requires works to be undertaken, a statement of the work (schedule, drawing or other document) should be prepared along with an estimate of value. The contractor would then be instructed to undertake the works. The work done should be measured by the Board and the value agreed between the Board and the contractor based on the contracted rates.
- 2.8 The Board's approach to commissioning work under the MTC is to ask the contractor to provide an 'MTC quotation' for works outlined by the MOs in advance of the works being undertaken. If the quotation is accepted, an order is issued and on completion of the work, the

contractor provides an invoice for the amount shown in the 'MTC quotation' – i.e. without the works being measured.

- 2.9 Managing the MTC in this way leaves a high degree of responsibility and control with the contractor who could have a financial incentive to supply a higher specification than that required by the Board. However, CDP have advised that they found no evidence that this has been misused.

Responsibility for Design

- 2.10 The contractor was asked by CPD but was unable to produce any drawings or other information prepared by Board officers which provided him with details of the work he was required to undertake. He stated that this was all done verbally. CPD highlighted a concern that the responsibility for design (particularly for fire alarms and emergency lighting) had been placed with the contractor as he may not be best placed or competent to undertake such design work. ***CPD recommends that the Board confirm that all installations undertaken by the contractor conform to the required British Standard.***
- 2.11 The contractor also stated to CPD that he did not provide test or commissioning certificates for any of the fire alarm installations because he had never been asked for them. These should have been requested/supplied as a matter of course and ***CPD recommends that the Board should ask for these to be provided retrospectively.***

Lack of Supporting Documentation

- 2.12 As part of the review, and in particular in preparation for the CPD site inspections, relevant supporting documentation was sought from the Maintenance Section. Internal Audit found that in many cases this could not be provided by the Board. This included basic documents which it would be reasonable to expect would be available to support the invoices paid – for example copies of written quotations which are referred to on the invoices and on which the charges are based and contractor timesheets.

- 2.13 Without the appropriate supporting documentation the Board cannot demonstrate that appropriate processes were followed to prevent fraud and loss and achieve value for money.
- 2.14 CPD was unable to conclude on the reasonableness of the costs in a number of the works they examined due to an absence of appropriate documentation.

Use of Subcontractors

- 2.15 CPD considered the process for procurement of 'specialist' subcontractors for items such as CCTV, barriers and door access and found that this was substantially undefined within the contract. CPD were informed by the contractor that they were instructed by the MOs in which subcontractor to use. In these circumstances it is the Board's responsibility to ensure the appropriateness and value for money of the subcontractors used. Internal Audit found limited evidence within the Board's files of a competitive process in relation to appointment of subcontractors.
- 2.16 Internal Audit identified 23 invoices where subcontractors were used. One invoice (order number 482188) included a subcontract to the value of £7,250, however, £8,250 was invoiced and paid. Internal Audit was unable to obtain a copy of the subcontract details from the Board for 13 of the invoices. The subcontracting costs were correctly charged for the remaining 9 invoices. ***The Board should recover this overpayment from the contractor and satisfy themselves that the charges in respect of the missing subcontractor invoices have been applied correctly.***

Dayworks

- 2.17 The Electrical Maintenance MTC provides for dayworks and specifies the rates to be charged. Internal Audit found that the invoices submitted were in accordance with the correct dayworks rates. However, Internal Audit found that a number of the invoices contained a significant proportion of dayworks (as high as 76% in one case). One MO advised

that the SMO had instructed that as long as any element of the work was within the MTC Schedule of Rates then it was appropriate to issue the order under the MTC.

- 2.18 CPD has advised that the Schedule of Rates used within the Electrical Maintenance MTC is very limited as it contains less than 200 items. The equivalent CPD schedule contains several thousand items. CPD consider that this has inevitably led to elements of work being priced outside the Schedule. This is allowable under the contract but the quantities and hours need to be regularly challenged by the Board officers. Internal Audit found limited evidence that this was consistently happening within the M&E Section.

Segregation of Duties

- 2.19 Internal Audit found that there was evidence of 2 people involved in the ordering and paying for work. However, during the course of our review, we were advised by the MOs that they had not been provided with a copy of the MTC until recently and at times did not have knowledge of specific issues. Internal Audit was advised by the MOs that, in these circumstances, they would have checked with the SMO and been instructed on how to proceed.
- 2.20 While having different officers involved in the process gives the appearance of segregation of duties, where an officer has limited knowledge of the requirements and places reliance on the directions of a more senior officer, this erodes real segregation of duties, one of the key defences against fraud. It appears that individuals have placed significant reliance on the knowledge and directions of the M&E Section SMO.

Orders Over Threshold

- 2.21 The MTC has an upper limit of £15k for any one order and on 23 occasions this limit has been breached. It is recognised that the actual cost of works can exceed the original estimate, however, there were a number of orders identified where the original estimate of costs

exceeded £15k. The MOs have indicated that they were only recently provided with a copy of the contract and had thought that the upper limit was £30k (consistent with the Standing Orders open competitive tendering requirements).

- 2.22 There are 3 orders valued in excess of £100k which relate to the installation of fire alarms and testing of fire alarm and emergency lighting systems. These orders represent works across a number of separate sites which have been combined into one order for administrative expediency.
- 2.23 While this is not strictly in accordance with the contract CPD have agreed with the Professional and Technical approach taken by the Board although have noted that it would have been prudent to have sought prior approval for this approach.
- 2.24 CPD considers the rates charged for the fire alarm and emergency lighting testing are 'very keen'. CPD checked a sample of fire alarm installations and considered that the costs charged were reasonable for the works undertaken.

Fire Alarm Function Testing

- 2.25 Over £105k was paid in respect of fire alarm function testing and associated repairs. Internal Audit had extreme difficulty in establishing on what basis this work was awarded. The orders state that this was done through the MTC, however, Internal Audit was advised by the MOs that a separate tendering exercise had been conducted. Despite a concerted effort to obtain the contract and tender documentation, this has not been produced. Having reviewed the available documentation and in light of the discussions between the contractor and CPD, Internal Audit consider that it is likely this work was done through the MTC. Internal Audit was advised that the M&E SMO would know the detail of this which again highlights the lack of knowledge of the MOs and the reliance placed on the SMO.

2.26 Internal Audit identified that the management report which provides details of the rotation of contractors for emergency response maintenance did not include the charge code for fire alarm maintenance. Internal Audit was advised that this was excluded at the instructions of the SMO as there was no requirement for rotation of contractors within this charge code. In the absence of a separate contract for fire alarm maintenance, Internal Audit considers that this code should have been included in the management report to ensure a full assessment of contractor rotation. In the 2009/10 financial year the Electrical Maintenance MTC contractor received 93.29% (£31,325.11) of fire alarm emergency response maintenance work.

Variation on Procurement Approach

- 2.27 Internal Audit noted that there were variations in the procurement approach for works of a similar nature, for example installation of electrics for whiteboards and overhead projectors. This work had been done through the MTC and also as emergency response work. There does not appear to be any correlation to the approach taken and the value or the timing of the order. In addition, these various approaches have all been used by the same MOs.
- 2.28 Internal Audit was advised that this type of work may have been processed as emergency response maintenance if the school had not provided sufficient notice that a contractor was required to install electrics for whiteboards and other equipment they had purchased.
- 2.29 Works such as the installation of electrics for whiteboards and overhead projectors do not appear to fall into the Board's definition of emergency response maintenance and charging it as such will result in inaccurate management information in relation to the amounts spent on maintenance. While it was not possible to obtain an accurate assessment of the values involved, it could potentially be significant.

Procedures for Non-Emergency Work Under £2k

- 2.30 The Board's Standing Orders specify the quotation and tender procedures required for works over the value of £2k, and there is an established procedure for emergency works under the value of £2k. However, the requirements for non-emergency response works under this value are not documented and Internal Audit was advised that the approach adopted can vary by individual. DFP have previously advised that where a number of quotes are required and a contract is awarded without any form of competition, regardless of value, it is a single tender action. Without a documented procedure for dealing with non-emergency response work under £2k there is a risk that the Board could inappropriately allocate work as single tender action without following the required business case and approval processes.

Mixed Orders

- 2.31 Internal Audit found that a number of the orders reviewed contained a mixture of response maintenance requests and works to be carried out under the MTC. However, the invoices for these orders did not separately identify the different elements of the job making it difficult to evaluate whether the costs charged were correct.

Other Procedural Issues

- 2.32 Internal Audit found a range of other procedural issues which were either of a minor nature or occurred in a small number of cases and have listed these below.

Order dates - a number of instances identified where the timesheets attached to the invoices indicated that the work was carried out before the order was issued. In some cases this was only a matter of days which could be attributed to the emergency nature of the work, however, in a number of other cases the work was completed up to 5 months before the order issued.

Same individual charged as an apprentice and labourer - It appears that the same individual has been charged as both an apprentice and a

labourer. As timesheets have not been provided for every response maintenance job the full scope of this issue cannot be quantified, however, Internal Audit reviewed this issue in relation to the 2007/08 year. If, as one would expect, he had been charged consistently as an apprentice throughout the period then the amount charged should have been £221.75 less than actually charged.

Overcharging – a small number of instances of overcharging of small amounts have been identified and these are considered to be mistakes on the part of the contractor. The details of these have been passed to the Board.

Evaluation

- 2.33 Internal Audit considers that the issues highlighted above represent serious internal control weaknesses and therefore provide an unacceptable level of assurance to the Accounting Officer. These weaknesses result in the Board being unable to demonstrate that fraud and loss were prevented and value for money achieved.
- 2.34 Internal Audit has sought advice on fraud risks from CIS. CIS advised that the issues identified did not represent evidence to suspect fraud or criminal activity had been perpetrated by any individual or organisation. However, Internal Audit considers that, while no evidence of fraud was uncovered, these weaknesses have left the system vulnerable to error, fraud or exploitation.

3. MTCs FOR BUILDING MAINTENANCE

Details of Review Undertaken

- 3.1 There are 11 current Building Maintenance MTCs across a range of disciplines. Unlike the Electrical MTC, there was no upper limit established for these MTCs.
- 3.2 Having carried out a 100% review of the Electrical MTC contractor invoices over £200, Internal Audit determined that it would be appropriate to review a sample of building maintenance invoices in the first instance, increasing the sample if required.
- 3.3 A sample of approximately 18% of the payments over £200 was selected across all current building maintenance MTCs. A small selection of response maintenance invoices was included in the sample.
- 3.4 The same approach was applied to the examination of these invoices as was applied to the electrical maintenance invoices. This included seeking appropriate supporting documentation and further explanations.

Findings

- 3.5 No significant concerns or issues were identified during the review.
- 3.6 Internal Audit found that the rates charged were in accordance with the MTC terms. In addition, supporting documentation, for example, written estimates, drawings and diagrams etc was available. DE Internal Audit also found evidence of Board Building Maintenance Officers checking and challenging the detail of the invoice, for example the measurement of the jobs.