

SWAP non-opinion audit – Highway Maintenance: Duplicate Payment Requests

Advisory Audit follow up report

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Summary	<p>The Highways Maintenance Contract is delivered by Milestone Infrastructure (previously Skanska Construction UK Ltd (prior to contract novation on 1st May 2021).</p> <p>In recognition of the scale and complexity of the Application for Payment (AfP) process, and specifically the risk of duplicate payment requests which had been identified through the certification process, SWAP Internal Audit Services (SWAP) was commissioned by the Highways Strategic Manager in May 2020 to:</p> <ul style="list-style-type: none">a) Establish the extent of duplicate payments applied for across the three-year contract period, through analysis of submitted AfP's; andb) Assess the extent to which both the internal and contractor processes are sufficiently robust to mitigate the risk of both duplicate payments being applied for and paid. <p>The original non-opinion audit outcome identified seven key findings where changes were required to provide full assurance. A follow up was commissioned by the Highways Strategic Manager in spring 2021 which SWAP undertook through summer 2021 and, concluded the report on 2nd September 2021.</p> <p>The follow up report concludes that the previously identified risk exposures are reducing but due to the size and complex nature of some of the actions required, improvement work remains in progress.</p> <p>This report provides an update to the Audit Committee on the progress of the addressing the issues identified and confirms that the service has requested a further follow-up audit, scheduled for the first quarter of 2022/23 financial year.</p>
Background	Somerset County Council (SCC) awarded the Highways

Maintenance Contract to Skanska Construction UK Ltd. The contract commenced in April 2017 and is valued at approximately £30m each year. In early 2020, Skanska notified the County Council, that following a strategic review of their business model, their parent company were commencing a process to divest themselves of Skanska Infrastructure Services, the delivery arm for Local Authority Highway contracts, in order to streamline their operations. On the 4th December 2020, M Group Services Ltd announced it had exchanged contracts for the purchase of Skanska UK's Infrastructure Services operation. On 1st May 2021, the Highway Maintenance Contract was novated to Milestone Infrastructure, a part of M Group Services.

Milestone submit a monthly AfP for all task orders relating to highways maintenance. A review of the AfP process was conducted by the Highways Service area for internal compliance in early 2020 and this highlighted two incidents amounting to £361k in value where Skanska, at the time, had failed to accurately assess the previous paid sum prior to applying for payment. This triggered an Early Warning Notice to Skanska in which three critical questions were posed, to gain a better understanding of the process:

- What checks are currently being undertaken to prevent potential duplications reoccurring?
- How did these duplications happen to slip through the current quality assurance processes already in place?
- What improvements can be made to the current checks and balances to ensure that these occurrences are kept to an absolute minimum?

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- a) Establish the extent of duplicate payments applied for across the three-year contract period, through analysis of submitted AfP's; and
- b) Assess the extent to which both the internal and contractor processes are sufficiently robust to mitigate the risk of both duplicate payments being applied for and paid.

The approach adopted by SWAP was a Risk Based Internal Auditing (RBIA) which is recognised as best practice. SWAP considered the probability of significant errors, fraud, non-compliance, and other exposures when developing the engagement objectives.

The initial non-opinion audit outcome identified seven key findings where changes were required to provide full

	<p>assurance. The follow up committed to undertake testing in relation to:</p> <ul style="list-style-type: none"> • all recommendations; and • evidence to support implementation of recommendations. <p>SWAP obtained payment data and conducted a number of analyses to assess the degree of improvement. SWAP also held interviews with certifying officers and Highways Management team.</p> <p>A copy of the follow up report is contained in Appendix 1 of this report.</p>
<p>SWAP follow-up audit conclusion</p>	<p>This follow-up review concluded that the previously identified risk exposures are reducing but due to the size and complex nature of some of the actions required, improvement work remains in progress.</p> <p>SWAP reported a new Contract Management Team and a new CONFIRM payment system are both on the verge of being implemented. The former represents an approved investment in further resource and the latter has involved a substantial amount of collaborative work between the Highway team, the system vendor and the contractor, which will eventually replace the current Application for Payment (AfP) spreadsheet.</p> <p>These improvements will vastly improve the financial and performance management of the Highway Maintenance Contract and also the process for scrutinising and certifying the task orders completed by the contractor, including the audit process.</p> <p>The audit report noted several SWAP’s previous findings and recommendations related to the size, format, and complexity of the AfP. While these issues are yet to be concluded, there have been several enhancements and alterations to manage and mitigate potential risk. Specifically, to improve the ease and timeliness of the monthly certification process by increasing the cost visibility of task orders. The Highways Team is performing detailed monthly analyses to track compliance and the impact of changes.</p> <p>The most significant issue identified from the original audit was a high differential between the ordered cost of works, compared to the actual cost applied for by the contractor. SWAP’s analysis has identified that recently implemented improvements have had some impact on reducing these differentials, but further progress is required. This will be</p>

	<p>achieved via the introduction of compensation events via the new payment system. However, in the interim, the Highway service area has implemented additional controls to manage any risks.</p> <p>In terms of the other areas where significant risks remain, these are principally with the amount and scope of auditing and the lack of thematic reporting, and also the reconciliation process, which is still limited to a three-month payment history.</p> <p>The activity in progress to address these risks, namely the establishment of the new Contract Management Team and a new payment system, are in the final stages of implementation.</p> <p>SWAP concluded further audit work will be required to assess the completion of the remaining actions, which will be in line with the revised implementation dates. A further follow up audit is targeted for early 2022.</p>
<p>Review activity and outcomes</p>	<p>The follow up report dated 13th September 2021 is contained in Appendix 1. This contains the narrative in respect of the original findings. The follow up progress is summarised in the table below:</p>

Audit Findings	Priority	Follow Up Status (Aug 2021)
Ref 1.1 - There are high differentials between the ordered and actual costs in the Application for Payment.	Priority 1	In progress
Ref 1.2 - Other issues with the cost visibility of orders in the Application for Payment may impact on the number of task orders refused for payment and re-applied for by the contractor.	Priority 1	Complete
Ref 1.3 - The amount and scope of routine auditing of highway task orders is not commensurate with the total value of expenditure, or the financial risks associated with the outsourced maintenance contract.	Priority 2	In progress
Ref 1.4 - The size and format of the Application for Payment exceeds the capabilities available from a spreadsheet and does not enable the certification process to achieve compliance with Financial Regulations. There is also a lack of cost visibility for certifiers.	Priority 1	In progress
Ref 1.5 - There is a lack of cohesion between the processes of the authority and the contractor that impact on the data quality of the Application for Payment.	Priority 2	Complete
Ref 1.6 - The authority's highway maintenance payment reconciliation process does not include sufficient data to be effective.	Priority 2	In progress
Ref 1.7 - The Application for Payment process does not have a realistic completion timescale given the complexity of the certification	Priority 3	Complete

	process.		
Actions to date	<p>The Highways Group continues to actively promote the delivery of the SWAP findings. This compliments the programme to critically assess and develop the contract management approach within the Highways Group led by the Strategic Manager - Highways.</p> <p>It is noted that some early interventions have been achieved, for example, removing notional low value task orders. It is also worth noting the engagement of staff, the increased organisational commercial acumen, and the cultural shift in relation to cost control has been exemplary.</p> <p>Whilst it is recognised further work is required following the appointment of the roles within the Contract Management Team, good progress has been made so far.</p> <p>Given that Milestone Infrastructure will be part of the solution, a separate work stream has been initiated with them to look at the end-to-end payment process; with specific inputs and focus on the SWAP recommendations. To date, we have seen good contribution and collaboration by the Contractor on this work programme.</p>		
Recommendations	<p>It is recommended that the Committee notes the progress set out in the follow up audit and, that a further follow up audit is planned in the first quarter of 2022/23 financial year and the Audit Committee will be updated as required.</p>		
Background	<p>On 28th January 2021, the Audit Committee reviewed and discussed 'SWAP non-opinion audit – Highway Maintenance: Duplicate Payments requests'.</p>		

Appendix 1 – Highway Maintenance - Application for Payment

The follow up SWAP audit dated 13th September 2021 is attached. The detail associated with the SWAP audit findings are contained within the report.