



REPORT BY THE CONTROLLER OF AUDIT

S.R. 99/10

**EAST AYRSHIRE COUNCIL
REVIEW OF PERFORMANCE OF BUILDING
AND WORKS DLO - 1998/99**

**A REPORT BY THE CONTROLLER OF AUDIT TO THE ACCOUNTS COMMISSION
UNDER SECTION 102(1) OF THE LOCAL GOVERNMENT (SCOTLAND) ACT 1973**

EAST AYRSHIRE COUNCIL

REVIEW OF PERFORMANCE OF BUILDING AND WORKS DLO - 1998/99

1. INTRODUCTION

- 1.1 On 11 December 1998 I reported (S.R. 98/6) to the Accounts Commission on the estimated deficit of £2.5m incurred by the Commercial Operations Department of East Ayrshire Council at 31 March 1998. My report focused on the performance of the Building and Works DLO which, alone, accounted for approximately £1.2m of this figure. After consideration of my report the Commission issued a number of findings and requested me to review the performance of the Building and Works DLO in 1998/99 and report back to them within a period of 12 months. This report is in response to that request.

- 1.2 My report is based on the review carried out by the Commission's Chief Auditor (East Kilbride) as an extension to his existing audit appointment. He reported to me on 18 October 1999 and I authorised him to make a copy of his report available to the Council. In addition, because of their interest in the matter and their statutory powers under the Local Government, Planning and Land Act 1980, I passed a copy of the report to Scottish Ministers. (These powers were previously exercised by the Secretary of State). My report has been prepared from information contained in the auditor's report and from additional enquiries which I have carried out.

2. PURPOSE OF THE REPORT

- 2.1 The purpose of my report is to advise the Commission of the progress achieved by the Council over the past year in addressing the factors which contributed to the 1997/98 deficit. I have reviewed the actions taken by the Council against the findings from my earlier report and against the Commission's findings, following their consideration of my report.

2.2 As a result of the 1997/98 deficit the Secretary of State exercised the powers available to him under Section 19B of the Local Government, Planning and Land Act 1980 and laid down conditions under which the Council would be permitted to continue the operation of its Building and Works DLO. The Secretary of State subsequently modified some of the conditions which he originally specified. As part of my recent review I have examined the extent to which the Council has met these conditions.

3. CONTEXT

3.1 The 1997/98 Building and Works DLO deficit remained undetected until after the financial year end because of the absence of reliable management information and the wholly inaccurate financial information presented to members during the year on the DLO's trading performance. When the full extent of the deficit became apparent in June 1998 the Council commenced an intensive programme of action to address the causes and to meet the conditions imposed by the Secretary of State for the continuing operation of the Department. The Council's actions consisted of measures which it was able to implement in 1998/99 together with longer term action which it has implemented in the current financial year. While the changes introduced by the Council have had a significant impact on 1998/99 their full impact will not be apparent until 1999/2000 and future years.

4. ASSESSMENT OF PROGRESS

4.1 In my report on the 1997/98 deficit I concluded that there had been wide ranging weaknesses in the management of the Commercial Operations Department especially in relation to the Building and Works DLO. I identified a range of factors which, in my opinion, had contributed to the DLO's adverse financial performance. These included:

- pricing the Council's maintenance contract significantly below the DLO's cost base
- the possibility of undercharging for work done
- high bonus earnings which were not matched by commensurate gains in productivity
- poor stores control resulting in a significant stock write-off

- refurbishment costs for the Commercial Operations Department head office which were £244,000 in excess of budget provision.

4.2 My overall assessment of the position identified the need for action to:

- improve the management of the Commercial Operations Department
- produce reliable and accurate management and financial information and performance reports for members
- involve members more fully in monitoring performance and approving remedial action where necessary
- secure a more viable bonus scheme
- improve business planning and budgeting

4.3 Following their consideration of my statutory report the Commission issued its own findings highlighting the need for:

- clarity regarding the roles, responsibilities and accountabilities of the Chief Executive, Director of Finance and DLO Manager
- a statement of the DLO's strategic objectives in service delivery which recognises the clear separation of client and contractor and involves the use of competition to demonstrate how the Council will ensure value for money
- a business plan explaining how the DLO can be run profitably
- adequate information systems, including accounting for income and expenditure on a full accruals basis
- a tender evaluation process which can demonstrate that DLO tender prices are viable.

4.4 Under the powers available to him in Section 19B of the Local Government, Planning and Land Act 1980 the Secretary of State directed the Council to cease undertaking any capital work from July 1998 and general highways work from 1 May 1999, and prevented the Council from undertaking building and maintenance work from that date without his consent. He subsequently modified his Direction to allow the Council to move towards the introduction of a mixed private/public sector economy for revenue maintenance works and to undertake limited capital works subject to certain conditions.

5. FINANCIAL PERFORMANCE IN 1998/99

- 5.1 At 31 March 1999 the Building and Works DLO showed a deficit for the year of £517,000. This figure excludes one-off redundancy payments of £843,000 incurred during the year as part of the restructuring of the Department to enable a proportion of work to be undertaken by the private sector. The year end position shows a reduction of some £700,000 in the previous year's deficit and a significant improvement in the £3.6m deficit which had been projected in June 1998.
- 5.2 In the auditor's assessment the improvement in the financial performance of the DLO in 1998/99 is due to the effective action taken by the Council to reduce the Department's cost base by revising the bonus scheme, reducing the workforce by around 30% and imposing better control over overtime.
- 5.3 The DLO is expecting to achieve a surplus of around £50,000 in 1999/2000. Management accounts at the end of September 1999 show the department as having made a surplus of £74,000. (The projected overall surplus for the Council's seven other DLOs/DSOs at 31 March 2000 is £291,000. The management accounts for the six months to 30 September 1999 show an aggregate surplus of £261,000).

6. ACTION TAKEN BY THE COUNCIL

- 6.1 When the 1997/98 DLO deficit came to light the Council embarked on an extensive programme of action to address the poor performance of the Department. The Council's action was heavily influenced by the need to meet the conditions laid down by the Secretary of State.

This section of my report summarises the action taken by the Council in key areas.

Structure and Governance Arrangements

- 6.2 The Council has implemented a major restructuring exercise under which all remaining commercial services from the Commercial Operations Department have been transferred to major client departments. This includes the transfer of the Building and Works DLO to the new Department of Homes and Technical Services (HATS).
- 6.3 On 18 June 1998 the Council established a Special ad hoc Commercial Strategy Review Committee which met a total of 30 times over a 12 month period and considered around 270 items of business. The relevant service Committees now have dual responsibility for client and contractor issues and this is reflected in a revised Scheme of Delegation. Members are also involved in monitoring the performance of DLO/DSOs through the new Budget Monitoring Group which considers income and expenditure variances.
- 6.4 The roles, responsibilities and accountabilities of the Chief Executive, Director of Finance and DLO Manager were re-affirmed and approved in April 1999. The Chief Executive is a member of the Budget Monitoring Group and takes an active interest in the formulation of the DLO's strategy and in its performance. He also chairs the Council's Senior Management Team which discusses DLO matters.
- 6.5 The Director of Finance is also a member of the Budget Monitoring Group. He is responsible for securing high professional standards in the finance function of the DLO and in monitoring its financial performance. He is also responsible for accounting teams out-posted to service departments, including the Department of Homes and Technical Services, to enhance core budgeting and accounting procedures.
- 6.6 The Director of the new Homes and Technical Services Department is responsible for both client and contractor functions and, in common with other directors, is accountable to the Budget Monitoring Group for variances in income and expenditure levels and for the financial performance of the DLO generally.

Strategic Objectives and Business Planning

- 6.7 The strategic objectives of the DLO are included in the Business Plan which is supported by other documents such as the Best Value Implementation Plan and the Building Maintenance Service Delivery Action Plan. The Business Plan has recently been completed, validated by independent consultants and approved by the Council. It recognises the respective responsibilities of the client and contractor functions and explains how DLO activities can be run profitably. The Council's strategy for Best Value embraces the use of competition to achieve value for money.

Financial Management and Control

- 6.8 Reference has already been made above to the formation of the Budget Monitoring Group and to the role which officers and members play in monitoring the financial performance of the DLO. Management accounts are prepared on a four weekly basis by the out-posted finance staff, for presentation to the Group. Income and expenditure is included on a full accruals basis throughout the year and includes central and departmental overheads. In their presentations to the Budget Monitoring Group service directors have to explain the reasons for variances, any policy implications and what action they are taking to bring the situation under control. The Group reviews the adequacy of the action taken and submits minutes of its meetings to the Policy and Resources Committee.
- 6.9 A new management information and costing system is scheduled for introduction by March 2000. This should improve further the quality of information and facilitate monitoring by individual job. The new system will be developed to reconcile with the main financial system.

Reduction of DLO Cost Base

- 6.10 To secure an immediate improvement in the DLO's financial performance in 1998/99 the Council implemented a series of measures to reduce the Department's cost base. These included the non-filling of vacancies which, together with voluntary redundancies, resulted in a reduction of 115 (30%) in the workforce. Overtime costs were monitored more closely and reduced, interim changes were made to bonus payments and the home to work

travel scheme was discontinued. A new bonus scheme, based on the time saved on individual jobs, has been introduced from 1 October 1999. During the year central service recharges were reviewed to achieve more equity and consistency in the allocation of costs.

- 6.11 The main reductions in DLO expenditure as a result of the action taken in 1998/99 were:

	£,000
Bonus payments	921
Wages	917
Overtime payments	83
Overheads	<u>468</u>
	<u>2,389</u>

Other Action

- 6.12 A series of other actions have been taken to improve the DLO's business efficiency. These include steps to reduce the backlog of recharges to departments for work done. Although recharging continued to be a problem throughout 1998/99 the backlog of charges was cleared in May 1999 and the process now operates on a regular four weekly basis. Recharging on a more current basis has enabled the accuracy of charges to be improved and any disputed matters to be resolved timeously between the client and the DLO.
- 6.13 Similar progress has been made in eliminating the backlog of processing of suppliers' invoices, the average time for which is now within the Council's target of 28 days. This improvement has also enabled the DLO to assess its ongoing performance more accurately.
- 6.14 The need to engage sub-contractors is now closely monitored and controlled. Generally sub-contractors are only deployed if the necessary skills or equipment are not available within the DLO or if capacity or timescale considerations dictate a need to do so. This has lead to a significant reduction in their use in 1999/2000.

6.15 The Council continues to experience problems in relation to its stores. An internal audit report issued towards the end of 1998/99 identified 11 matters as requiring high priority attention. One of the weaknesses identified was the absence of control to ensure that all stores issue notes are processed. Action is ongoing to address stores weaknesses, including the implementation of a new computerised stores and purchasing system. The Internal Audit Department is assisting the DLO with stock checks and continues to monitor stores controls.

New Contracting Arrangements

6.16 The Council engaged independent consultants to assist in the process of contract packaging, tender preparation and tender evaluation in respect of contracts tendered without DLO bids. Multi-trade and gas maintenance contracts for two geographical areas, comprising 35% of revenue maintenance, have been let to the private sector with effect from August and October 1999.

6.17 Consultants have been used to evaluate and assess the contract rates payable to the DLO to ensure that it operates on the basis of private sector equivalent rates. These became applicable from 1 October 1999. Agreement has been reached with the workforce on revised working practices, to enable services to be delivered within the new rates.

6.18 The DLO is only permitted to undertake limited capital works and these are subject to certain conditions.

7. CONCLUSION

7.1 Since the discovery of the 1997/98 DLO deficit the Council has undertaken an intensive programme of action to address the poor performance of the DLO, to meet the conditions imposed by the Secretary of State and to respond to the findings from my earlier report and those made by the Accounts Commission.

- 7.2 Some of that action, such as the reductions in the workforce and the cost base, was implemented within the 1998/99 financial year. Other aspects, such as the letting of the maintenance contracts to the private sector, have been introduced in the current year. Further action, with a target date of March 2000 is proposed including the introduction of a new management information and costing system and a new stores system.
- 7.3 The swift action taken by the Council enabled the DLO deficit to be reduced from £1.2m in 1997/98 to £517,000 in 1998/99. The Council is projecting a surplus of £50,000 at 31 March 2000 and the interim trading results for the first six months of the current year show a surplus of £74,000.
- 7.4 The Council considers that the medium term action plan for the Building and Works DLO is now substantially complete. The Business Plan for the Department has been finalised, validated by external consultants and submitted to the Scottish Executive acting on behalf of Scottish Ministers. The next version of the plan has to be submitted before the end of January 2000 and will address the long term objectives and how the DLO will achieve continuing improvement.
- 7.5 The Building and Works DLO is to undergo an EFQM Excellence Assessment and the Property Maintenance Service will be subject to a service review. The scheduling of both reviews will be set by the Performance and Best Value Unit and the output will be used to determine whether the Property Maintenance Service is delivering Best Value. In the auditor's assessment the Council has complied with the Secretary of State's Directions and has substantially addressed my findings and those of the Commission. To achieve the projected DLO surplus for 1999/2000 and to ensure that costs remain with the income levels generated by the new private sector equivalent pricing structure the Council needs to continue to monitor the DLO's action closely.



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