

Argyll and Bute Council

Internal Audit Report

November 2022

FINAL

Externally Funded Projects- Rothesay Pavilion

Audit Opinion: Substantial

	High	Medium	Low	VFM
Number of Findings	0	2	1	0

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1. Executive Summary

Introduction

1. As part of the 2022/23 internal audit plan, approved by the Audit & Scrutiny Committee in March 2022, we have undertaken an audit of Argyll and Bute Council's (the Council) system of internal control and governance in relation to Externally Funded Projects-Rothesay Pavilion.
2. The audit was conducted in accordance with the Public Sector Internal Audit Standards (PSIAS) with our conclusions based on discussions with council officers and the information available at the time the fieldwork was performed. The findings outlined in this report are only those which have come to our attention during the course of our normal audit work and are not necessarily all the issues which may exist. Appendix 1 to this report includes agreed actions to strengthen internal control however it is the responsibility of management to determine the extent of the internal control system appropriate to the Council.
3. The contents of this report have been agreed with the appropriate council officers to confirm factual accuracy and appreciation is due for the cooperation and assistance received from all officers over the course of the audit.

Background

4. The refurbishment of the Rothesay Pavilion is the final project in the Councils' plans to assist regeneration and economic development in its 5 waterfront towns namely Campbeltown, Helensburgh, Oban, Rothesay and Dunoon. The strategic aim of the project is to bring the building back into economic use by allowing a mix of new commercial, cultural and community activities to be provided within it that will stimulate local economic activity and contribute to the wider regeneration of Rothesay.
5. The contract commenced on site on 29th November 2017 and was initially scheduled for completion in 87 weeks with a contractual completion date of 31st July 2019. As a result of works variations in the contract, this was extended with a proposed final handover in February 2020. However, due to the administration of the main contractor CBC Glasgow the project is currently being re-assessed and a completion date has yet to be finalised.
6. The Rothesay Pavilion full business case under section 1.7 emphasised the requirement for external funding to enable the project to go ahead and consequently a number of external funders were identified by the Council namely:

Name	Amount
Heritage Lottery fund(HLF)	£4,187,500
HLF-Volunteer Input	£50,900
European Regional Development Fund (ERDF)	£1,055,602
Highland and Islands Enterprise(HIE)	£750,000
Regeneration Capital Grant Fund	£625,000
Coastal Communities Fund	£600,000
Historic Environment Scotland	£750,000
West Coast Foundation	£116,957
Scottish Landfill Communities Fund	£20,000
Total	£8,155,959

7. All external funders provide a grant offer letter to the Council which sets out the terms and conditions that the Council should meet in order to satisfy the grant requirements.

Scope

8. The scope of the audit was to assess the Councils compliance with the terms and conditions as specified by the external Fund providers as outlined in the Terms of Reference agreed with the Head of Commercial Services on 24th June 2022.

Risks

9. The risks considered throughout the audit were:
 - Audit Risk 1: the council does not have an agreed offer letter in place from external providers specifying terms and conditions
 - Audit Risk 2: the council does not have procedures/processes in place to ensure that grant requirements are met
 - Audit Risk 3: the Council has failed to ensure compliance with the requirements stipulated within grant letters
 - Audit Risk 4: the council does not have reporting arrangements in place to appropriate Council bodies in order to provide assurance that grant requirements are met
 - Audit Risk 5: Reputational risk to the Council.

Audit Opinion

10. We provide an overall audit opinion for all the audits we conduct. This is based on our judgement on the level of assurance which we can take over the established internal controls, governance and management of risk as evidenced by our audit work. Full details of the five possible categories of audit opinion is provided in Appendix 2 to this report.
11. Our overall audit opinion for this audit is that we can take a Substantial level of assurance. This means that internal control, governance and the management of risk is sound. However, there are minor areas of weakness which put some system objectives at risk and specific elements of residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.

Recommendations

12. We have highlighted two medium priority recommendations and one low priority recommendations where we believe there is scope to strengthen the control and governance environment. These are summarised below:
 - outstanding grant claims should be followed up timeously;
 - action plan should be prepared to determine the extent of completion of project that can be achieved based on available funding;
 - consideration should be given to reviewing extensive use of external contractors
13. Full details of the audit findings, recommendations and management responses can be found in Section 3 of this report and in the action plan at Appendix 1.

2. Objectives and Summary Assessment

14. Exhibit 1 sets out the control objectives identified during the planning phase of the audit and our assessment against each objective.

Exhibit 1 – Summary Assessment of Control Objectives

	Control Objective	Link to Risk	Assessment	Summary Conclusion
CO1	The Council has procedures/processes in place to ensure compliance with grant letter terms and conditions	Audit Risk 1 Audit Risk 2	Reasonable	All external funders have issued a grant letter outlining the terms and conditions attached to funding. T&C's have been agreed by the Council. Risk registers are in place that identifies risk in relation to funders with mitigation actions specified. Extensive use of external contractors was noted.
CO2	Procedures/processes to ensure compliance with grant offers conditions are applied	Audit Risk 3	Substantial	Internal audit took assurance from the external review carried out by the Scottish Government that the Council were compliant with EU funding guidelines in regard to funding from European bodies. A grant claim submitted to ERDF for £308k is outstanding dating back to April 2021.
CO3	There are appropriate reporting arrangements in place to Council bodies to provide assurance that grant terms and conditions are met	Audit Risk 4	High	Comprehensive highlight reports are produced on a regular basis by the project manager which covers all issues pertinent to the project including compliance with external funding requirements. Regular meetings are held with external funders and chaired by the head of commercial services. Updates to Council committees are provided periodically. Financial services issue regular updates on the capital spend of the project. Action plan to determine the extent of completion of project that can be achieved based on available funding should be prepared.

15. Further details of our conclusions against each control objective can be found in Section 3 of this report.

3. Detailed Findings

The Council has procedures/processes in place to ensure compliance with grant letter terms and conditions

16. The Principal Contractor, Central Building Contractors (Glasgow) Ltd (CBC), was placed in Administration by its' Board of Directors, and this was formally notified to the Council on 29 April 2020. At the Policy and Resources committee dated 9th December 2021 it was decided to 'pause' the Rothesay Pavilion Project due to a forecast of a significant funding shortfall to complete the works, with various follow on actions agreed for Elected Members and Officers to progress to try to close the 'gap'.
17. Included within the funding shortfall is the financial risk of circa £6.85M which is the value of external funding thus far claimed against the capital costs of the project, and which funder's may seek to recover if the Rothesay Pavilion project is not satisfactory concluded in regard to funding requirements.
18. The majority of the capital funding is being provided by the Council (41%) and the Heritage Lottery Fund (HLF) (30%) respectively. The capital grant awards include standard and specific terms and conditions that are required to be met in delivering the project by the Grantee/s (i.e. Council and the Rothesay Pavilion Charity (RPC)). The terms and conditions include delivery of approved purposes and activities, performance reporting and monitoring, governance processes, and completion/evaluation reports.
19. All External funders have issued a grant letter to Argyll and Bute Council that sets out the terms and conditions (T&C's) that the Council should meet. The standard T&C's are applicable in the event of specific circumstances such as :
- the Grantee commits a default;
 - the funder considers that any change or departure from the purposes for which the grant is awarded warrants an alteration to the amount of the grant;
 - failure to carry out the project;
 - progress of the project is not satisfactory;
 - fraudulent and/or negligent activity incorrect or misleading information;
 - future of the project is in jeopardy;
 - grantee's change in status i.e. insolvency or winding up
 - disposal of asset: subject to prior written consent up to 15 years. Permission is dependent on: the Grantee pays a share of the net proceeds and the sale must be at full market value
 - the terms and conditions will be applicable from between 6 to 10 years.
20. Specific terms and conditions are split between those expected to be met by the Council and those expected to be met by the Rothesay Pavilion Charity (RPC). As regards the specific requirements of the Council each of the funders has a requirement for the Council to deliver against the specified approved purposes and benefits. These can be summarised as follows:
- repair of the historic fabric of Rothesay Pavilion;
 - upgrade of main auditorium to support events programme and to create 3 nos. business units: Café/Bistro. 2 nos. bars and shop/box office;
 - creation of new community facilities including music rehearsal and recording space, a second venue with independent entrance targeted at young people, function rooms including new roof top multi-purpose space;
 - new exhibition space with high quality permanent and temporary exhibition space for changing programmes;
 - heritage interpretation space for display;
 - refurbishment of the Caretaker's House to provide offices for local SMEs;

- community Arts projects – Video & Photographic record of interviews; film and creative skills weekends;
- creation of a historic archive;
- marketing and Communications: increased community engagement through development workshops with Schools and improvement in visitor offer;
- heritage interpretation space: design & themed content.

21. Both the Highlands and Islands Enterprise Board (HIE) and European Regional Development Fund (ERDF) have specified a number of defined benefits which are summarised below namely:

- enhanced community venue;
- one income generating asset;
- £287k per annum increase in turnover in the social economy;
- 14 full time equivalent jobs;
- 30 volunteers engaged with project delivery;
- 40 people accessing training;
- 40 community groups increasing their capacity through engagement with pavilion activities;
- 2 organisations supported to deliver growth aspirations

22. The project manager prepares a regular ‘Highlight’ report on the ongoing status of the Rothesay Pavilion Project. The report includes under section 7 an update on the current risks associated with the project including the following :

- Identifies the risk
- assess the likelihood and impact of the risk
- prioritise the risks (red, amber or green)
- How the Council will mitigate and manage the risks identified.

Commercial Services also identified within their overall risk register the risk of “unavailability of internal capital funding” for all projects including Rothesay Pavilion and prioritises the risk as “red” with mitigation actions including ensuring resources are available to complete projects.

23. The project includes a full time project manager as well as support from a variety of internal Council bodies such as Legal and Planning and administration and external bodies such as design and conservation architects. The initial project manager left 5 months into the construction period in May 2018 and a new project manager was recruited in August 2018. Strategically the project was managed internally by the council’s project manager, however, in terms of day to day activities and implementation there was a heavy reliance on external consultants and contractors. Consideration should be given to reviewing the extensive use of outside contractors as opposed to investing in in-house resources in regard to major capital projects especially in light of the projected overspend on the project.

Action Plan 3

Procedures/processes to ensure compliance with grant offers conditions are applied

24. Due to the Scottish Government (SG) being ultimately responsible for ensuring that EU funded projects are properly administered a review was undertaken by the SG the on behalf of HIE and ERDF during the 1st Quarter of 2021 i.e. post the administration of the main contractor. (Note :EU funding represents 21% of total external funding) The review was termed a “stage 2 on the spot verification” which included the following :

- the eligibility, status and outcome of participants/businesses (where applicable);
- the expenditure declared and the existence and compliance of the audit trail for a number of expenditure items (involved checking 23% by value of all claims made by the Council);
- the outputs and/or achievements linked to the operation(s);
- the compliance with the relevant eligibility rules, public procurement, state aid instruments, environmental, financial instruments, horizontal themes and publicity.

The outcome of the audit was that all criteria checked were found to be fully compliant and no actions by the Council were required.

25. All claims submitted against each external funder are recorded on a claims summary. A summary of outstanding balances yet to be claimed as at the time of the audit is shown in the table below.

Funder	Grant-(£)	Claimed-(£)	Received (£)	Balance to be claimed-(£)
HLF	4,187,500	3,,627,657	3,627,657	559,843
HES	750,000	525,000	525,000	225,000
HES COVID	62,794	62,794	62,794	0
ERDF	1,055,602	929,078	621,171	434,431
HIE	750,000	744,253	744,253	5,747
Total				1,225,021

26. The balance outstanding in regard to ERDF and HIE is due to the grants being payable on completion of specified percentages of work done on the project. The Council has procedures/processes in place whereby a qualified quantity surveyor who is independent of the Council and the contractors evaluates and certifies the work completed at each stage to enable grant claims to be made timeously. This involves the following :

- External building contractor required to assesses the work completed and materials on site and applies for payment via the Cost Consultant/QS
- A&B representative i.e. QS measures and agrees the work completed and materials on site and assesses the value prior to agreeing the Contractors application for payment;
- the Architect/Contract Administrator then issues a valuation certificate for the monetary value as advised by the QS;
- once agreed the contractor issues an invoice based on the agreed figure;
- the invoice is checked/matched against the Valuation Certificate and is then approved for payment by the Project Manager. This operation has a specific ledger code which is then applied to the invoice then passed to the DA's finance department for payment;
- the ledger is checked each month to ensure that all invoices have been correctly coded;
- claim is then submitted.

All claims against outstanding grant balances funders are currently on hold.

27. A claim of £307,907 was submitted to ERDF in April 2021 and as at August 2022 this claim has not been paid by ERDF. Verification on the status of the outstanding claim has yet to be received.

Action Plan 1

There are appropriate reporting arrangements in place to Council bodies to provide assurance that grant terms and conditions are met

28. The project manager produces on a regular basis a 'highlight report'. A review of the reports found them to be comprehensive and included the following :

- Program Summary
- key performance indicators such as cost summaries , cash flow and budgets
- key issues including communications with Funding Partners, grant claims
- progress against Plan
- budget
- major Issues including compliance with grant requirements from external funders
- major risks i.e. risk log
- 4 week horizon

Issues pertinent to addressing grant offer conditions are included within the highlight reports. The report is forwarded to all appropriate Council committees including Area committees, Strategic Management Team (SMT) and Policy and Resources Committee.

29. Due to the terms and conditions varying for each of the funders the project manager produces on a monthly basis a bespoke report for each of the funders that reflects the areas covered within the highlight reports. In addition the project manager has arranged for site visits on a number of occasions when requested by funders.

30. Regular meeting are held with all grant funders and chaired by the Head of Commercial Services. A review of the attendees confirmed that all funders were present at the meetings. A review of minutes subsequent to the administration of the main contractor included the following:

- Update on progress by the project manager including all areas of concern
- financial update including latest projected cost forecasts
- implications for Project completion
- feedback from external Funders concerning their concerns
- outline of actions going forward including discussions with Partners over additional funding

The project manager has also supplied comprehensive updates to the main funders during the course of the project.

31. The Council has extensive reporting arrangements in place to provide assurance to stakeholders that grant terms and conditions are met. A summary of the Council bodies who are regularly updated with issues pertinent to the Rothesay Pavilion Project including funding issues is shown below:

Body	Regularity	Issues discussed
Policy and Resources Committee	Every 2 months	Update included where appropriate in agenda Committee is updated on major developments
Departmental Team meetings	Weekly	Updated on budgets , current issues
External Funders meetings	Quarterly	Chaired by Head of Commercial Services
Commercial Services Team Meetings	6 weekly	Updated on budgets , current issues
Rothesay Pavilion Charity Board	Quarterly	Current progress update on Rothesay Pavilion Re-development
Bute and Cowal Area Committee	Quarterly	Update included where appropriate in agenda

32. Financial Services provide a regular update on the capital spend of all projects including Rothesay Pavilion. Project managers provide comment on any issues, update the forecast spend and provide details of any slippage or acceleration of spending. Financial Services monitor the return of these spreadsheets and follow up non returns and query those returned with either no comment or insufficient comment. Financial Services present the capital monitoring report to SMT on a monthly basis and as a standard agenda item to each meeting of the Policy and Resources Committee (except the May meeting).
33. Whilst our review of the reporting arrangements was satisfactory, it nevertheless identified that there are considerable financial and reputational risks associated with the project. These risks need to be addressed in terms of compiling a plan to take forward the funding gaps with funding partners and determining the extent of completion that can be achieved based on available funding.

Action Plan 2

34. During the course of the audit a number of issues were identified that did not fall within the scope of our review but which nevertheless should be considered. It may be of benefit that a review by internal audit on the Rothesay Pavilion Redevelopment project be considered as plans for the next stages of development are taken forward as funding becomes available. Discussions with the project team noted that they would expect a full review /audit of the project to take place especially if extra funding is required from the SG.

Appendix 1 – Action Plan

	No	Finding	Risk	Agreed Action	Responsibility / Due Date
Medium	1	<p>Outstanding Claims</p> <p>A claim of £307,907 was submitted to ERDF in April 2021 and as at August 2022 this claim has not been paid by ERDF. Verification on the status of the outstanding claim has yet to be received.</p>	Failure to follow up status of outstanding claims may lead to non-payment.	Followed up with HIE as Agent for Scottish the Government. Due to the uncertainty the SG confirmed they are not in a position to settle the outstanding claim relating to the Pavilion.	Project Manager Completed.
Medium	2	<p>Project Plan</p> <p>There are considerable financial and reputational risks associated with the project. An action plan to take forward the funding gaps with funding partners and determining the extent of completion that can be achieved based on available funding should be prepared.</p>	Failure to prepare an action plan to determine extent of completion based on available funding may lead to non-completion of project.	A revised construction strategy has been developed with options. This is a work in progress with a key output being a report to P&R.	Project Manager January 31 st 2023
Low	3	<p>Resources</p> <p>Consideration should be given to reviewing the extensive use of outside contractors and consultants as opposed to investing in in-house resources in regard to major capital projects especially in light of the projected overspend on the project.</p>	Failure to address the Councils use of external resources may lead to in house resources not being efficiently utilised.	As part of the End Project Report, Lessons Learned, a review of the decision pertaining to project resourcing will be undertaken, and recommendations made to Head of Service with respect to the on-going efficient resourcing of projects. In developing future projects the Council will continue to give consideration to the most efficient resourcing model.	Project Manager 30th June 2023

In order to assist management in using our reports a system of grading audit findings has been adopted to allow the significance of findings to be ascertained. The definitions of each classification are as follows:

Grading	Definition
High	A major observation on high level controls and other important internal controls or a significant matter relating to the critical success of the objectives of the system. The weakness may therefore give rise to loss or error.
Medium	Observations on less significant internal controls and/or improvements to the efficiency and effectiveness of controls which will assist in meeting the objectives of the system. The weakness is not necessarily substantial however the risk of error would be significantly reduced if corrective action was taken.
Low	Minor recommendations to improve the efficiency and effectiveness of controls or an isolated issue subsequently corrected. The weakness does not appear to significantly affect the ability of the system to meet its objectives.
VFM	An observation which does not highlight an issue relating to internal controls but represents a possible opportunity for the council to achieve better value for money (VFM).

Appendix 2 – Audit Opinion

Level of Assurance	Definition
High	Internal control, governance and the management of risk are at a high standard. Only marginal elements of residual risk have been identified with these either being accepted or dealt with. A sound system of control designed to achieve the system objectives is in place and being applied consistently.
Substantial	Internal control, governance and the management of risk is sound. However, there are minor areas of weakness which put some system objectives at risk and specific elements of residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.
Reasonable	Internal control, governance and the management of risk are broadly reliable. However, whilst not displaying a general trend, there are areas of concern which have been identified where elements of residual risk or weakness may put some of the system objectives at risk.
Limited	Internal control, governance and the management of risk are displaying a general trend of unacceptable residual risk above an acceptable level and placing system objectives are at risk. Weakness must be addressed with a reasonable timescale with management allocating appropriate resources to the issues raised.
No Assurance	Internal control, governance and the management of risk is poor. Significant residual risk and/or significant non-compliance with basic controls exists leaving the system open to error, loss or abuse. Residual risk must be addressed immediately with management allocating appropriate resources to the issues.