

Internal Audit Report

Waste PFI Review 2015

To: Steve Loudoun - re3 Project Director

Date: 4/8/15

Ref: 3/15 v3



Substantial
Assurance

1 Purpose and Scope of Review

- 1.1 The Re3 partnership of Bracknell Forest, Wokingham and Reading Borough Councils was first established in 1999 to develop waste management facilities across the area. In 2006 a 25 year PFI contract was let to FCC Environment to manage and dispose of all the household, and some trade, waste from the three boroughs in line with guidelines and regulations.
- 1.2 Re3 has two main sites, namely Smallmead and Longshot Lane and the management and administration of the contract is undertaken by a small team of officers based at Smallmead. In turn the team is managed by a Project Director and a Joint Waste Disposal Board, drawn of Councillors from each of the boroughs. The administration and governance requirements for the scheme are laid down in a Joint Working Agreement (JWA).
- 1.3 This internal audit review is carried out every 2 years by the RBC Internal Audit team on behalf of the 3 boroughs. The previous reviews were carried out in 2011 and 2013.

2 Main Conclusions

2.1 Governance

- 2.1.1 There is a clear understanding by all partners to continually review the key elements of the contract, structure, roles and responsibilities of the main parties as defined in the Joint Working Agreement (JWA) and that this is continually being applied to ensure it remains fit for purpose. Legal advice has been sought to improve the Contract to reduce the risk of future disputes. In addition to the offer of awareness seminars held for members of the Joint Waste Disposal Board (JWDB), it has been highlighted that it would be helpful to produce a consolidated guidance document which explains the relationship between elements of the Contract.
- 2.1.2 There are satisfactory arrangements in place to monitor and appraise the strategic and operational risks for re3. Members of the Senior Management Group are responsible for assessing how or whether these risks should be reported in their Local Authority's Annual Governance Statement.

Internal Audit Report

Waste PFI Review 2015

2.1.3 To coincide with the restructure of re3 in 2015, the SMT recognised that the delegated authorities for the JWA need to be reviewed so that this dovetails with the new roles and responsibilities that have been agreed by the JWDB. It is our opinion that this would also be an opportune time to also develop the terms of reference for the SMT and as already identified by the Project Director.

2.2 Contract Management

2.2.1 The role of the re3 Project Team was reviewed in 2015 by the JWDB, who agreed that the team should be restructured and resourced to enable a strategic approach.

2.2.2 The Contract clarifies both the self-monitoring responsibilities of the contractor (33.2) and the real-time scrutinising role for the local authorities have been embedded (33.3) to monitor the contract. Our observations are as follows:-

- We were informed the output specification as specified under Schedule 3 of the Contract is to be reviewed. This will coincide with the imminent review of the Joint Waste Strategy which expired in 2013.
- Although the JWA already clarifies the role and responsibilities of the project team, it is our opinion that in order to reduce any possible perceptions of inter-borough conflicts of interest, we have advised that terms of reference reaffirming the representation protocols would be useful. However, we are satisfied that the team does represent the interests of the collective as a whole.
- Although there is a risk the contractor could over report its service and performance delivery, we are satisfied there is a robust inspection programme to independently test and verify this. Issues arising have been satisfactorily integrated within the risk management framework. To strengthen its approach, we have suggested that the contract monitoring programme should be reviewed and authorised annually to confirm the focus remains appropriate. The Project Team has also introduced a database and reporting mechanism to clarify the status of service and performance issues raised with the contractor.
- Management is proactively seeking to improve communication. However, we believe this could also be extended to improving access to key governance documentation and performance data. JWDB Agenda, Minutes and Terms of Reference are not published on the re3 website and no weblink is provided to Bracknell Forest Council. Although the contractor publishes an annual report of its service performance, it is our opinion the contractor could also publish its recycling performance statistic each month etc. on the re3 website and Twitter.

Internal Audit Report

Waste PFI Review 2015

2.3 Finance

2.3.1 Payments to the contractor are based upon a monthly estimation of tonnage (as a reflection of the annual budget) which is adjusted quarterly to actual. A sample test of payments recorded on the general ledger for 2014/15 confirmed these are supported by an invoice and a 'calculator' to transparently explain the basis and methodology for the payment. Our observations are as follows:-

- There are good separations of duties in place between the officer responsible for monitoring service delivery and the checking and processing of payments. Although payments are checked and submitted by the Finance Officer, a copy of which is sent to Accountancy to support their review and authorisation, we have advised these payments should be reviewed and authorised by the Strategic Waste Manager before submission. Moreover, a list of delegated authorisations should also be considered to enhance ownership. This will help develop knowledge of the payment mechanism and resilience amongst the newer members of the Senior Management Team.
- Sample testing of a quarterly payment an 'on-account' payment confirmed the invoice sums for December 2014 and March 2015 were satisfactorily verified and correctly calculated. The integrity of the activity report of weighbridge transactions supporting the quarterly submission for December 2014 was examined and found to be satisfactory.

2.3 A total of 8 recommendations have been raised in respect of this review, of which none have been considered a high priority. The full detail of these recommendations and the corresponding management action plan are attached to this report as Appendix 1.

Internal Audit Report

Waste PFI Review 2015

3. Summary of Findings

3.1 Governance

3.1.1 Joint Working Agreement

The JWA sets out the various obligations of parties in relation to the principal contract, administration, decisions, the Joint Waste Disposal Board, principal contract management and the standing orders to be applied.

Section 27 of the JWA clarifies the requirements and time frame for ensuring the review and renewal of the terms of the JWA to agree any changes that may be required. To this end it was noted that:-

- The JWDB was informed on the 14/3/15 on the progress being made towards addressing Members' requests for greater understanding of important elements of the re3 Waste PFI contract. It has been highlighted there is a need to produce a consolidated document to produce a consolidated guidance document which explains the relationship between elements of the Contract (See Rec 1).
- We were informed by both the Project Director and re3 Strategic Waste Manager that there is a desire to simplify elements of the Contract to ensure clarity following resolution of the dispute. Importantly, it has been demonstrated there is a 'Lessons Learnt' culture so that there is continual improvement. We are aware that steps are being taken (at time of writing) to incorporate such simplification within the contract amendments arising from the proposed dispute settlement.
- We noted a supplementary JWA was approved on 11/5/2012 following approval of the original JWA on 31/10/2006. The Strategic Waste Manager highlighted the capacity within the principal Contract for either re3 or the contractor to instigate formal contractual Change, however to date there have been few changes.
- Awareness seminars were proposed in 2014 to inform JWDB members how elements of the contract, such as the payment mechanism, worked.

3.1.2 Joint Waste Strategy

Both the Project Director and re3 Strategic Waste Manager reported the partnering LAs are prepared to review the need for a joint re3 waste strategy in 2016 as the current strategy¹ requires updating. It was explained this should sit comfortably and in parallel to the individual council waste collection strategies and corporate elements of the

¹ Re3 Joint Municipal Waste Management Strategy (2008-2013)

Internal Audit Report

Waste PFI Review 2015

imminent Minerals and Waste Planning process. The Strategic Waste Manager will produce an re3 waste strategy. This was also a recommendation that was accepted by management following the 2013/14 audit review² (See Rec 2).

3.1.3 Joint Waste Disposal Board

Schedule 2 of the JWA clarifies the constitutional arrangements of parties to form a Joint Waste Disposal Board³ (JWDB) to work together to secure the proper exercise of those powers and duties required under the Environmental Protection Act 1990.

Together with meeting agendas, minutes etc, it was noted the terms of reference for the JWDB, which are agreed at the annual AGM together with positions, are published by Bracknell Forest Council. The terms of reference clarify that the JWDB is not responsible for making decisions on the change to the policies and targets of the Councils or the determination of the budget of the Councils regarding the Project.

We noted the re3 website could be improved to provide clear access to JWDB documents and to provide a clearer overview of the current performance status (See Rec 3).

3.1.4 Senior Management Group

The Senior Management Group (SMG), which is made up of a senior representative from each of the 3 authorities recognises there is a need to develop terms of references for both the SMG and the Project Team to clarify their purposes. Currently the position of the Project Director is organised on a willingness/knowledge basis and it is considered by the group that the appointment of SWM will help support and maintain resilience (See Rec 4).

Conflicts of interest risk for the SMG has been assessed to be very low by Project Director and he explained that any conflicts would be managed through a meeting of the Berkshire Chief Executives. It was further explained the competencies for each representative are managed via their respective local authorities' performance management framework.

3.1.5 Project Team

To complement the JWDB's review of the roles and responsibilities of the Project Team on the 22/1/2015, the re3 Strategic Waste Manager confirmed the team's job descriptions were reviewed by the SMG in March 2015 in preparation for the restructure and recruitment initiative in May 2015.

² Previous audit report 6/13, dated 5/9/13, recommendation 5.

³ Bracknell Forest Council has delegated responsibility for administrating the Joint Waste Disposal Board.

Internal Audit Report

Waste PFI Review 2015

The JWDB “considered a report setting out proposals for a new management structure for the re3 project that would ensure the project’s structure remained fit for purpose for the remaining lifetime of the contract. It noted that the proposals had been developed with the intention of bringing about stronger collaboration between the re3 councils, develop the collection and disposal interface and bring about greater strategic presence and impact for the re3 contract across the three councils as well as improving capacity and strategic guidance.”

3.1.6 Risk Management

A risk register⁴ is maintained to record and report strategic and operational risk status for re3. The register satisfactorily profiles the various performance standards which inform each risk, which are predominately services related and detail proposed mitigation plans of action e.g. a strengths and weaknesses analysis for the administration of the contract monitoring and the JWDB reviewed a report regarding service continuity⁵.

Each Local Authority is required to publish its Annual Governance Statement (AGS). SMG members are responsible for reviewing and reporting back relevant control issues to their own respective local authorities for consideration.

Reading Borough Council’s Internal Audit and Investigations Team is required to carry out an audit every 2 years on behalf of the re3 partnership. This arrangement does not allow for the prompt follow-up of recommendations (See Rec 8).

3.2 Contract Monitoring

3.2.1 Contract Monitoring Provision

At the time of our review, the Project Team employs 3 people (2.6 Full Time Equivalent). We are satisfied the Project Team presents a professional outlook to protect the interests of the partnering authorities. A Board review of the project team’s function and governance structure in 2015 agreed the team should be enhanced and resourced so that it could take responsibility for a more strategic approach to mitigate the potential risk of waste growth due to the improving economy. To complement the Board’s review, the Strategic Waste Manager confirmed the team’s job descriptions were reviewed as well.

⁴ Previous audit report 6/13, dated 5/9/13, recommendation 6.

⁵ Previous audit report 6/13, dated 5/9/13, recommendation 4.

Internal Audit Report

Waste PFI Review 2015

Project Team costs are administered by RBC are recharged at the end of each financial year to the local authorities equally, with the exception of any waste related costs. Each local authority is responsible for its own internal monitoring of costs.

3.2.2 Contract Monitoring & Reporting

Contract Schedules 25 - 26 'Performance Mechanism' clarifies the service plan criteria and performance standards to be met.

Contract Schedule 7 sets out the method statement and the contractor's approach for delivering the services specified. The SWM commented the Service Delivery Plan also details the contractor's 'offer' of service to the local authorities.

Although DEFRA provided re3 with an introductory contract monitoring manual at the start of contract to help develop a set of documented procedures, we are satisfied the Project Team has documented and implemented an effective test programme (Summary of Performance Mechanism Monitoring, which is underpinned by the Contract) detailing its approach for monitoring the risks attaining to service delivery and performance. In particular the following observations were made:-

- We are satisfied that the status of service delivery risks and performance standards have been incorporated into the re3 strategic register and that there is an audit trail to the Summary of Performance Monitoring Mechanism Monitoring records⁶.
- In accordance with the contract, the contractor produces a monthly service delivery and a performance report for the Project Team. For purposes of completeness and accuracy, these reports are cross examined by the re3 Monitoring & Performance Officer, who maintains independent records to verify the 'default point' and 'performance deduction' required. The Project Team has now introduced a query log to improve the effectiveness and transparency of issues being highlighted by the Project Team. This records the review status of outstanding service/performance issues and their frequency and provides a clear audit trail and breakdown of the defaults being applied.
- The re3 Strategic Waste Manager has highlighted that the impact of any change, resulting from new strategic priorities, will need to be fully evaluated to ensure compliance with the Public Contract Regulations 2015. A copy of the Project Team's analysis showing the priorities of each of the partnering LAs and their objectives was produced together with the relevant related performance standard. For reference, there are 74 performance standards, of which one (SO4:1 'Product

⁶ Previous audit report 6/13, dated 5/9/13, recommendation 7.

Internal Audit Report

Waste PFI Review 2015

Markets') is used to measure the attainment of the main priority to support the local economy as well as six customer service standards.

- Although the contractor provides a breakdown of their performance standard results to substantiate the total reported, the Project Team does not have access to contractor's information system to independently verify completeness. Information held on the database is recorded by the contractor when completing a 'Daily Site/KPI Log' for each of the two sites, and a copy of the Log is forwarded to the Project Team for information. Despite this and as directed by the Project Team's Testing Programme, the Project Team is able to effectively challenge the completeness and accuracy of the performance standard results. As an observation, we noted, the performance standards monitored via the 'Daily Site/KPI Log' are not aligned to the output risks being reported via the Project Team's 'Summary of Performance Mechanism Monitoring' risk profile and the reporting of results by the contractor (See Rec 5).
- In continuation from the previous audit and although not specifically examined, the Project Team reported 'bring bank' performance has continued to be an issue⁷. A resolution to this issue is being actively be pursued by the Project Team.
- The re3 Strategic Waste Manager has highlighted that although there are satisfactory controls in place to confirm/escalate/resolve performance issues between re3 and FCCE, the Contractor's approach for managing this has not always been satisfactory. Although the financial implications of performance deductions are immaterial in context to the gross cost of the contract, the issue of a mutually accepted protocol for managing such issues could help improve relations, reliability of information and reduce the administration costs. The Project Team has introduced a formal process to document issues being and their feedback status and this has, thus far, been successful.
- We have advised the monitoring programme should be reviewed and approved annually by the senior managers' team to ensure the focus and approach remains appropriate to the risks and issues being highlighted by the Project Team (See Rec 5).

3.2.3 Recycled Pass Through Costs

FCCE held a presentation for re3 Project Team to demonstrate and provide evidence of their procurements of the 'pass through' costs for waste wood, hardcore and paints. It was noted that on the 24/6/15:-

⁷ Previous audit report 6/13, dated 5/9/13, recommendation 8.

Internal Audit Report

Waste PFI Review 2015

- FCCE carry out an annual review of their 'off-taker' companies. The Project Team has been invited to participate in the 2015 review. Companies are vetted to ensure continuity of service and spot audits are conducted to ensure they can meet the specification requirements required by FCCE.
- Although product price indices are used to guide the cost specification, these are subject to daily price fluctuations. In order to remain commercial FCCE's procedures remain flexible to accommodate this. The Materials and Marketing Department is responsible for obtaining and negotiating prices, and for submitting a summary report for its Boards decision. It was agreed that FCCE would develop a procedure so that re3 is informed of decisions, especially where materials were being stored for a favourable rate (See Rec 7).

3.3 Finance

3.3.1 Payment Mechanism

Schedule 24 (Payment Mechanism) of the Contract, sets out the parameters and calculation methodology for the contractor's application for payment and for the Project Team to make payment. Monthly payments are based upon an agreed estimated tonnage forecast, which are then adjusted quarterly against actual tonnage. Each local authority is responsible for ensuring its proportional charge is correct.

3.3.2 Review & Authorisation of Payment Application

The JWA specifies that Bracknell Forest Council's Standing Orders are to be used for compliance purposes. It should be noted Schedule 4 'Delegated of Responsibilities' fails to clarify the responsibilities of officers for ensuring payments are appropriately authorised. Payments to the contractor are processed via CHAPS⁸ by Accountancy once the re3 Finance Officer has satisfied herself that the invoice is correct. As recommended in the previous audit report copies of the weighbridge checks are now retained by the Project Team⁹ to confirm the additional spot checks carried out. A copy of the 'unitary calculator' is also forwarded as evidence support. In order to improve separation of duties, we have proposed that a scheme of delegation for authorising payments to involve the Strategic Waste Manager etc. should be introduced (See Rec 6).

⁸ CHAPS stands for Clearing House Automated Payment System. It's an automated payment system used to make payments on the same day in the UK, in sterling (providing the payment instruction is received before 1:00 pm).

⁹ Previous Audit Report 6/13, dated 5/9/13, recommendation no. 1

Internal Audit Report

Waste PFI Review 2015

3.3.3 Accounting

A subjective code has been established on the general ledger¹⁰ to account for payments made to the contractor. A full sample check of two invoices made during 2014/15 proved satisfactory.

3.3.4 Substantiation of Payments

a) We examined an 'on account payment' for the period March 2015 and found the charge was satisfactorily calculated:-

- The monthly 'on account' payments are correctly based and calculated upon forecast tonnage which is proportioned¹¹ according to usage arising from the findings of civic amenity usage surveys at Longshot Lane and Smallmead.
- The cumulative tonnage used to calculate the payments for the baseline, recycling and composting were found to be correct to the forecast tonnage for the period. Testing confirmed the correct proportion of tonnage had been appropriately indexed linked and multiplied in accordance with the tonnage bands defined in the JWA.

b) We examined the quarterly adjustment for December 2014 and found the charge was sufficiently supported and calculated in accordance with the JWA:-

- A variation report was produced to explain the cost differential between the forecast charge and the actual charge for the quarter.
- A tonnage data transaction report for the period was provided to support the calculation of each element charged for on the invoice by the contractor for sample checking by the Finance Officer. A statistical¹² sample test confirmed the transaction report for December 2014 was accurate, although we noted a 4% error margin where the driver had failed to certify the weighbridge ticket¹³. These transactions are reconciled against the tonnage tracker which defines the type of waste and quantifies for the calculation.
- The cumulative tonnage used to calculate the payments for the baseline, recycling and composting were found to be correct to the forecast tonnage for the period. Testing confirmed the correct proportion of tonnage had been appropriately indexed linked and multiplied in accordance with the tonnage bands defined in the JWA.

¹⁰ Oracle Fusion

¹¹ Proportionment: Longshot Lane , BFC 55%, WBC 45%; Smallmead RBC 50.5%, WBC 49.5%

¹² Statistical Sample: A sample size of 50 against a population size 6,125 transactions (Smallmead 3,054, Longshot Lane 3,071) with a confidence level of 95%, provides an error margin of +/- 13.8 per finding.

¹³ Previous audit report 6/13, dated 5/9/13, recommendation 2.

Audit Management Action Plan Waste PFI 2015/16

| Ref | Risk | Recommendation | Priority | Management Response | Responsible Officer(s) | Target Date |
|-----|---|---|------------|---|--|--|
| 1 | Resilience to understand the extensive and complicated Contract is at risk. | To aide knowledge resilience there is a need to produce a consolidated document to provide a simplified updated overview of the Contract. | Priority 3 | The suggestion to produce such an overview document is acknowledged as a means to aid new members to the Board and the senior managers team | Strategic Waste Manager | 01/01/2016 |
| 2 | Because the Joint Strategic Disposal Strategy is out of date there is no strategic direction. | The Joint Waste Disposal Strategy and a Strategic Plan to deliver it should be produced. | Priority 2 | The Board are aware that existing strategy needs to be updated. To do so requires the re3 Councils to have produced their waste collection strategies as both are inter-related. The strategy will need to be signed off by the Board after due process | Senior Management Team | First Draft March 2016, adoption by March 2017 |
| 3 | There is a need to improve access to key governance records. | Access to information which is already in the public domain could be improved. Consideration should be given to:- * Providing a web link to JWDB Meeting Agenda, Minutes etc. at Bracknell Forest Council. * Monthly performance data, could be published on the re3 website and the new Twitter account etc. | Priority 3 | Agreed - subject to re3 Ltd giving approval as they own the web site Agreed - subject to re3 Ltd giving approval as they own the web site | Strategic Waste Manager Strategic Waste Manager | October 2015 October 2015 |
| 4 | Purpose and function of the Senior Management Team and Project Team requires clarification. | Consideration should be given to developing terms of reference for the Senior Management Group and the re3 Team to ensure these dovetail with the new roles and responsibilities. | Priority 3 | Agreed. The commitment to do so has already been given to the JWDB | Senior management team | Report to JWBD Oct 2015 |

| | | | | | | |
|---|---|--|------------|---|--|---------------------------------------|
| 5 | The focus and approach for monitoring 74 performance standards should be reviewed and approved. | Consideration should be given to approving which performance standards within the contract monitoring programme are monitored to ensure the focus remains appropriate to managerial needs. This should also help inform FCCE's focus to that there is a 'golden thread' principle in operation. | Priority 3 | Agreed. | Senior management team | Arrangements in place from April 2016 |
| 6 | Re3 should be able to better demonstrate the separation of duties in the authorisation of payments. | Although payments to the contractor are appropriately authorised by RBC Accountancy, it is our opinion:- * Consideration should be given to developing a list of 'delegated payment authorities' for * A certification programme needs to be introduced to ensure the Budget Holder is directly held accountable should be | Priority 3 | Agreed. We need to confirm the arrangements as to authorised signatories to ensure we also have cover and arrangements to escalate should it be needed. | Senior Management Team Senior Management Team | October 2015 October 2016 |
| 7 | The disposal status of 'off taker' of products have not been transparent. | The 'Off taker' arrangements agreed with FCCE which allows for the status monitoring of products should be formalised. | Priority 3 | Agreed | Strategic Waste Manager | October 2015 |
| 8 | The bi-annual internal audit programme does not permit the prompt follow-up of recommendations. | A follow-up audit should be carried out in 2016 to report back the implementation status of the recommendations made in this report. | Priority 3 | Agreed. | Senior Management Team | October 2015 |