

REPORT TO: Audit and Governance Committee

MEETING DATE: 20 February 2018

BY: Depute Chief Executive (Resources & People Services)

SUBJECT: Internal Audit Report – Performance Bonds

1 PURPOSE

- 1.1 To inform the Audit and Governance Committee of the recently issued audit report on Performance Bonds.

2 RECOMMENDATION

- 2.1 That the Audit and Governance Committee note the contents of the Executive Summary and Action Plan.

3 BACKGROUND

- 3.1 A review of the internal controls surrounding Performance Bonds was undertaken as part of the Audit Plan for 2017/18.
- 3.2 The main objective of the audit was to ensure that the internal controls in place were operating effectively.
- 3.3 The main findings from our audit work are outlined in the attached report.

4 POLICY IMPLICATIONS

- 4.1 None

5 INTEGRATED IMPACT ASSESSMENT

- 5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

6 RESOURCE IMPLICATIONS

6.1 Financial - None

6.2 Personnel - None

6.3 Other - None

7 BACKGROUND PAPERS

7.1 None

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DATE	8 February 2018

EAST LOTHIAN COUNCIL – INTERNAL AUDIT PERFORMANCE BONDS

1. EXECUTIVE SUMMARY

1.1 Introduction

A review of Performance Bonds was undertaken as part of the Audit Plan for 2017/18. A summary of our main findings is outlined below.

1.2 Areas where Expected Controls were Met

- For capital projects where the value of the work exceeds £250,000, the instructions issued to tenderers by one service area require that a performance bond is submitted by the successful contractor.
- For the six performance bonds reviewed, we found that the bond amount was as per the requirements of the contract – in each case, the bond submitted to the Council was for 10% of the tender amount.

1.3 Areas with Scope for Improvement

- The Council does not have a clear policy on the use of performance bonds – the current Standing Orders/Corporate Procurement Procedures make no reference to the requirement for performance bonds. *Risk – lack of a consistent approach to mitigate the risks arising from the failure by contractors to perform their obligations under a contract.*
- In two cases reviewed, we found that contractors had failed to submit a performance bond as required by the contract conditions. In one case, the Council had sought to partly mitigate the risk by retaining an additional 10% retention up to the practical completion date, however in the other case there was no evidence of action being taken to mitigate the financial risks to the Council. *Risk – failure to mitigate the risks arising from performance failures.*
- In some cases, we found that performance bonds received by the Council had expired prior to the issue of the certificate of practical completion. *Risk – failure to ensure that adequate cover was in place for the appropriate period.*
- The central register of performance bonds being maintained by Legal was found to be incomplete – in some cases, performance bonds were not being passed to Legal by service areas for recording and safekeeping. *Risk – lack of a clear audit trail.*

1.4 Summary

Our review of Performance Bonds has identified a number of areas with scope for improvement. Detailed findings and recommendations are contained in our main Audit Report.

Mala Garden
Internal Audit Manager

February 2018

**EAST LOTHIAN COUNCIL – INTERNAL AUDIT
PERFORMANCE BONDS**

ACTION PLAN

PARA REF	RECOMMENDATION	GRADE	RESPONSIBLE OFFICER	AGREED ACTION	RISK ACCEPTED/ MANAGED	AGREED DATE OF COMPLETION
3.1.1	<p>Management should review the current arrangements in place to ensure that the Council is adequately safeguarded from financial risks should a contractor fail to perform their obligations under a contract.</p> <p>Management should ensure that the outcome of the review is communicated to all service areas to ensure that a consistent approach is adopted for capital projects.</p>	Medium	Head of Council Resources	Agreed		April 2018
3.2.1	Management should ensure that contractors submit a performance bond to the Council where this is a requirement of the contract conditions.	Medium	Team Manager – Cost and Procurement	<p>Agreed – we will endeavour to ensure bonds are provided when specified. However, guidance is required for instances when a contractor cannot provide a bond due to circumstances unknown at tender stage (see recommendation 3.1.1 above).</p>		February 2018

PARA REF	RECOMMENDATION	GRADE	RESPONSIBLE OFFICER	AGREED ACTION	RISK ACCEPTED/ MANAGED	AGREED DATE OF COMPLETION
3.2.2	Management should ensure that the performance bonds submitted to the Council fully comply with the requirements of the contract conditions.	Medium	Team Manager – Cost and Procurement	Agreed – future contract conditions will stress the required bond expiry.		February 2018
3.3.1	Management should ensure that an accurate and complete record is maintained of all performance bonds held by the Council.	Medium	Team Manager – Cost and Procurement	Agreed – all future bonds will be issued to Legal for registering and safekeeping.		February 2018

Grading of Recommendations

In order to assist Management in using our reports, we categorise our recommendations according to their level of priority as follows:

Level	Definition
High	Recommendations which are fundamental to the system and upon which Management should take immediate action.
Medium	Recommendations which will improve the efficiency and effectiveness of the existing controls.
Low	Recommendations concerning minor issues that are not critical, but which may prevent attainment of best practice and/or operational efficiency.