



REPORT

ON

SYSTEM BASED AUDIT OF THE LITTLE BAY DEVELOPMENT PROJECT PHASE I

**OFFICE OF THE AUDITOR GENERAL
BRADES, MONTSERRAT
SEPTEMBER 2009**

**SYSTEM BASED AUDIT
OF
LITTLE BAY DEVELOPMENT PROJECT – PHASE I**

This is the report of a system based audit we conducted under section 8 of the Audit Act 2001.

September 2009

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FOREWORD

The Office of the Auditor General has decided to expand the range of services it offers to its clientele. A request was made to conduct a financial audit on the Little Bay Development Project Phase I. Due to the expulsion of Galloways contract and the absence of specific terms requiring auditing of contractor records we were unable to undertake that audit. We were subsequently asked to pursue a system based audit (SBA) as an alternative.

Most of the systems and processes were effective and the relevant checks and balances were in place. However, we were disappointed with the handling of an aspect of the tendering process.

Our expectations for how the project should be managed were generally met. However, suggestions for improvements and recommendations were made for two main areas: the tendering process and the continuation of the new arrangement for phase 2.

During the course of the audit, we interviewed several staff involved in the Little Bay Development Project. We wish to convey our gratitude for the information shared and assistance given.

Florence A Lee
AUDITOR GENERAL

September 2009

SUMMARY

The development of a town at Little Bay was identified as a high priority and the estimated cost of the first of four phases was over EC\$20m. In 2007, J E Galloway was awarded the contract and began work in March 2008. His inability to complete the project within the agreed time frame led to his expulsion in April 2009. Subsequently, a new partnership under the Galloway contract was established between the Government of Montserrat, MHL and DLN to ensure completion of phase 1.

Systems and processes put in place were done in accordance with the relevant documents, rules and legislations. We found that most systems and processes were effective during the tender process, contractor's work period and the partnership arrangement. However, we also found that:

- The contractor's financial information was outdated.
- JE Galloway had no international or large construction project experience.
- A significant aspect of the controls was breached in the decision to allow Galloway to tender. It appears as if the decision maker(s) did not seriously take the recommendations issued by the evaluation team into consideration.
- The new partnership arrangement was less risky and benefited the local economy.
- The required checks and balances were in place and the varying levels of approvers reduced the occurrence of irregularities.

We recommend the following:

- Projects of this nature and size should ensure that relevant experience is mandatory to prevent recurrence of failure.
- Audited financial statements should not be more than two (2) years old.
- Evaluation team recommendations should be respected and not be overlooked.
- The new partnership be used until completion of the entire project because of the benefits derived.
- A procedures manual be drawn up and approved to be used as a project guide.

PART 1

In this section, we set out:

- background and rationale for the project;
- why we undertook the audit;
- objectives of our audit;
- scope of this audit and;
- the methodology

1.1. Background & rationale for the project

Between 1995 and 1997 the Soufriere Hills volcano in southern Montserrat destroyed the capital town. As a result the island lost its administrative, business, cultural and social centre and much of the private sector activity that contributed to GDP ceased. Consequently, development of a town at Little Bay was identified as a high priority. A 10 year – 4 phases Little Bay Development Plan was developed to allow for a town centre development. The total estimated cost of the Little Bay Development Project (LBDP) Phase 1 is £4.31m (EC\$21.06m)ⁱ.

In 2007, J E Galloway & Associates was awarded the contract to create the basic infrastructure: preparatory earthworks, main drainage, installation of electrical, water and sewage treatment systems and construction of roads and car parks with a completion date set for 9th March 2009. Work commenced on 10th March 2008. This original contract has since ceased because of an inability to complete the project within the agreed time frame. Under the addendum to the original subcontract, a new partnership agreement between DLN, MHL and the Government of Montserrat was developed to ensure completion of phase 1.

1.2. Why we undertook the audit

We are committed to conducting a number of annual performance and special audits in order to provide assurance to parliament on how effectively and efficiently projects are administered and monitored.

ⁱ Project Memorandum, Little Bay Development Project: Phase 1 – November 2007

We agreed to conduct the audit of the LBDP at this time for a number of reasons. There was a genuine public interest in this failed contract. Secondly, in March 2009, a request was made to the Office of the Auditor General for a financial audit to be carried out on JE Galloway & Associates in relation to the project. Due to the expulsion of that contract and the absence of specific terms requiring auditing of contractor records we were unable to undertake an audit of financial transactions. We were subsequently asked to pursue a system based audit (SBA) as an alternative. SBA is a methodology designed to check upon adequacy and effectiveness of systems and controls. It focuses on the most strategic and high-risk areas, it is performance oriented, and it is proactive.

1.3. Objectives of the audit

Our audit sought to assess and report on the systems, processes and procedures in relation to the LBDP that were in place from the Government of Montserrat's (GoM) position.

The four broad objectives of our SBA were to:

- To assess the tendering process;
- To assess the procedure of change orders;
- To determine whether payments were only for bona fide work completed; and
- To assess the effectiveness of the monitoring procedures.

1.4. Scope of this audit

The audit focused on PWD operations and documentations and other related stakeholders specifically related to the LBDP Phase 1 and were conducted during the period June to September 2009. Our audit:

- Examined the Central Tenders Board (CTB) minutes, decisions and relevant documents to ensure compliance with the tender process.
- Reviewed progress reports, addendums and other documents to assess the approach for amendments or changes.
- Reviewed the payment verification process to ensure compliance with Financial Regulations and other related rules and regulations.

- Examined the extent of the monitoring procedures in place.

The auditor monitored this audit closely and has amended some areas so as to maximize the efficiency of the audit.

1.5. How we conducted the audit

The Ministry of Finance is tasked with co-coordinating the operation of the CTB and the Financial Secretary is its Chairman. During our visit to that office, we had informal discussions with secretary of the CTB. We were also given access to the required files. Key staff at the Little Bay Site Office was interviewed in order to gain an understanding of the procedures that were in place. We also interviewed engineers and administrative staff at the Ministry of Communications and Works.

We also reviewed documents, including tender documents, contracts, progress reports, addendums and other related documents to establish the systems in place and assess their functionality. The auditor also has endeavored to highlight the new procedures used for the finalization of the phase 1 in the absence of a manual.

The findings of this report were discussed with the Permanent Secretary, Development and her views were taken into consideration when finalizing this report.

Part 2

In this section, we will outline the procedures that were undertaken during the contractor's period and whether or not the systems were functioning adequately.

2.1. Tendering Process

The LBDP Phase 1 went through the process of inviting parties to submit an expression of interest by public advertisement, followed by evaluation of offers and selecting a successful bidder. We reviewed minutes of the CTB, examined related documents and sought clarification from staff.

1. We found that the Tender Documents such as instructions to bidders, general conditions of contract and other documents drawn up by DLN were very detailed and easy to follow.
2. J E Galloway submitted audited financial statements for 2001, 2002 and 2003 when they tendered for the project in 2007. This indicates clearly that their submissions were outdated and many things could have happened to the business from 2003 to 2006.
3. Tender information submitted by J E Galloway on form 1 section 1.6 under *General Information about the Tenderer* requested the information on the number of years experience that the contractor has internationally. The answer given was 10 yrs. However, on form 9 section B – *Experience as Contractor* the number of years experience the company had in the international arena was 0. The auditor came to the conclusion that both responses were contradicting each other.
4. The gathering of information was very time consuming and tedious for the auditor as two or more departments were involved in this project.

2.2. Variation Process

We found that small changes which occur during the course of the contract were handled through site instructions and the quantities were re-measured prior to certification for payment. For larger variations the approval of the Client (i.e. Government of Montserrat) was required prior to the issue of a site instruction to the contractor confirming the change. In the case of formal variation, DLN the supervising engineer, requests the contractor to produce cost for change of work and if the contractor fails to do so then the engineer would determine cost. We found that there have been some changes made to the LBDP and the system has been followed for variations required.

2.3. Payment Verification Process

Contractor completes work and every month prepares a Contractor's Valuation and submits to DLN. DLN certifies payment request against satisfactorily completed work and forwards completed certification along with recommendation for payment to PWD. PWD draws up a payment certificate based on recommendation and this is then forwarded to Development Unit for payment. We found that the system was effective during the contractor's work period.

2.4. Monitoring Process

The project was monitored closely by the engineer representative – DLN who checked quality of work in accordance with the specification and quantity of work to recommend payment. DLN also had the responsibility for ensuring work is done in accordance with the approved project schedule. At the end of each month a progress report for the project was completed and issued to various stakeholders. The Director of Works and the Engineer also monitored the project by attending meetings, constantly visiting the site and engaging in dialogue with various stakeholders.

2.5. Our Conclusion

1. In our view, the systems in place for this contract were implemented in accordance with the contract documents, Financial Regulations 2002, Public

Finance (Accountability and Management) Act 2008 and Financial Standing Orders. The processes used under the contract were appropriate under the circumstances.

2. The processes highlighted above were effective during the contractor's work period. The required checks and balances were in place and adhered to in ensuring that quantity and quality of works were done in relation to payment. Expressions of interest and tender documents were submitted by the due date and time.

3. Initially, the evaluation team did not shortlist J E Galloway for the opportunity to tender for the project as documentation revealed they failed the evaluation criteria for pre-qualification for the tender. There were the issues of having insufficient experience to meet the requirements of the project and insufficient personnel to undertake a project of this magnitude. A protest was later made by Galloway and they were allowed to submit a tender. A memo dated July 16th, 2007 was sent by the Financial Secretary to the PS, OCM advising him that the matter has been concluded in favour of J E Galloway. There was no formal documentation or evidence that revealed that the decision to allow Galloway to submit a tender was made by the CTB. We were however informed that the decision to allow Galloway's to tender was made at the policy level but the auditor was unable to find supporting documentation to validate this.

4. Further discussion and examination revealed that even though Galloway was the successful bidder there were outstanding issues for clarification even when the company started the project. This left the auditor to contemplate whether a statement that was made in the CTB minutes "**It was pointed out that funding for this project may not be available if the project suffer further lengthy delays**"ⁱⁱ was the reason why issues highlighted in this report were not fully clarified or implemented prior to the commencement of the project.

5. Clarification of financial information was a precondition and the auditor found no documentation or any evidence in the CTB minutes or Ministry of Finance correspondences that all outstanding information was submitted. The financial

ⁱⁱ Minutes of Central Tenders Board convened at the MOF on Thursday 29th November, 2009.

status of JE Galloway was essential in assessing the ability of the company to undertake a large project. The statements submitted by the company were outdated and would not have shown a true picture of the current financial performance of Galloway.

6. Additionally, at the time of JE Galloway expulsion on 6th April 2009 only 54.63% of work was completed according to the March 2009 Progress Report and 53.66% according to the April 2009 Progress Report. This highlights that at the end of the contract year only half of the work was completed which clearly reflected that JE Galloway was unable to undertake a project of this magnitude. It is our opinion that lack of experience was one of the key factors for the failure of this company to see the project through to the end.

An email from Director, PWD to Internal Auditor, Regulator dated July 4, 2009 highlighted that Galloway's most recent contracts carried out for the Government, had not been delivered without contractual difficulties.....the Director also mentioned that the acceptance of contractors with good experience in this type of work only will reduce the risk of time slippage. Additionally, CTB minutes and correspondences documented the expression of serious concerns by former PS, MCW which also highlighted the previous poor performance by Galloway's in relation to government projects.

Progress reports and other documentation have highlighted that the client knew about the slow progress Galloway have been making during the project. We feel that Galloway was given a lot of latitude in continuing the project and that the contractor should have been expelled long before the one year deadline. This experience should be a lesson learnt and the Government of Montserrat should be careful when considering further projects of this magnitude.

7. It is our view that the CTB minutes were not sufficiently detailed. Additionally, it appears that some discussions were not recorded.

2.6. Our Recommendations

1. In the future, relevant experience should be mandatory for projects of this nature and size.
2. We recommend that the CTB ensures that updated audited financial statements are submitted and be a prerequisite for tender. We are of the view that financial information should not be more than 2 years old.
3. An evaluation team was selected to appraise expressions of interest and their expertise in this area is of paramount importance in the tender process. We are of the view that the recommendations of this 'technical' team should be respected.
4. For the evaluation and assessment processes in relation to expressions of interest and the actual tendering we feel that more rigid guidelines (terms of reference/ ToR) should be implemented for all the related parties to adhere to. Procurement and Stores Regulations Part III sections 11-16 addresses tenders but this is not very detailed in terms of responsibilities etc.
5. All tender decisions, including those relating to pre-qualification, should be made collectively by policy makers. They should take into consideration the recommendations of the technical committees. Furthermore, whatever the decision, it should be clearly documented for accountability and transparency purposes.
6. We recommend that a more standard system amongst the involved departments be put in place for easy retrieval of information associated with projects.
7. CTB minutes should be more detailed and should capture the actual flow of discussion in relation to the agenda. In most cases it appears as if only board decisions are recorded.

PART 3

3.1. Current Partnership Arrangement

In this section, we outline the current agreement in place and the systems that have been implemented and their effectiveness.

A partnership consisting of PWD, DLN, & MHL was developed to ensure the completion of Phase I and it took the following form -

1. Project Management Contract between MHL & PWD
2. Engineering Supervision Contract between PWD and DLN
3. Direct payment of Plant, Material, and Labor by PWD following certification by full-time PWD Site Representative

The Government of Montserrat took this course of action to allow for the completion of various vulnerable parts of the project which would be exposed to great losses if not completed before the rainy season. MHL went through the process of re-measuring the works and determine the resources – materials, labor and equipment that were required to complete phase I. For this partnership, the facility was put in place to pre-pay for materials and post-pay for labor at costs and equipment at rate and only for the number of hours used.

3.2. Variation Process

Once there was a need to change then:

- DLN awaits approval of Client of major changes
- DLN issues Site Instruction to MHL for addition or deletion of works
- MHL would re-measure the works and determine what resources are required and these would be cross checked by DLN who also looks at volume or measured work of original bill.

3.3. Payment Verification Process

We found that MHL, the project managers prepares detailed estimate of equipment, labor and materials required to complete work. This has been vetted by DLN.

a. Direct Labor - Process

- Site Supervisor records time persons work;
- Time keeper verifies work done and signs off;
- Payroll clerk prepares payroll based on timesheets and submits to PWD Site Representative for certification; and
- Certified payroll sheets forwarded to PWD for sign off and then passed on to the Treasury.

In relation to subcontractors, MHL would determine which works can best be done by 'packaging' small elements. These are then allocated to local contractors who undertake the works under supervision by MHL. Payment is subject to satisfactory completion.

b. Plant/Equipment - Process

- MHL determines type and amount of plant/equipment required to complete a required task and arranges for plant mobilization;
- Plant supervisor checks items of plant being used and duration used;
- Timekeeper also double-checks plant utilization throughout the day;
- Suppliers submit invoices for payment of plant and equipment used to MHL who verifies invoices against signed-off tickets. MHL then prepares the relevant requisition and submit this, along with the invoices to PWD Site Representative for certification; and
- Certified requisitions and invoices are forwarded to PWD for payment.

c. Materials - Process

- MHL prepares requisition form for materials in advance of requirement on site;
- Requisition passed on to PWD Site Rep for verification and approval;
- Approved material requisitions passed on to PWD. PWD then issues LPO for items;
- Materials obtained from supplier and “received” by MHL storekeeper;
- Payment made to suppliers based on approved LPO accompanied by relevant invoice submitted to PWD;
- Material requisition checked against overall material estimates; and
- A list of all payments made by the Treasury in relation to the project is made available to the PWD Representative, who reconciles these payments against submitted requisitions.

We found that the payment process has been functioning adequately there have been minor errors but because of the many checks and balances in place these have been discovered and rectified before payment was made.

3.4. Monitoring Process

The quality assurance and program schedule monitoring process is the same as when the contractor was undertaking the project. A monthly progress report for the project was done. Estimates of what the cost would have been if the previous contractor did the work were included as a basis for evaluating the effectiveness of the decision to run the project jointly.

3.5. Our Conclusion

In our view this new system was less risky for the Government of Montserrat than the contract system. This partnership system benefits Montserrat and locals because under the previous contractual arrangement the contractor subcontracted equipment and labor from outside the country. For this system, work was offered to locals resulting in increase economic activity.

Our sample check on invoices, bills and various forms showed that the authorized officers approved the documents and in some cases there were at least 2 approvers prior to payment. The required checks and balances were in place and the varying levels of approvers prevented irregularities.

The project partnership arrangement is shared among parties who at this time appear not to be profit-motivated and because of the many systems and processes in place no one party could carry out a major decision unless the other two are on board.

3.6. Our Recommendations

It is noted that the partnership arrangement is working well financially and can be a model for future projects. We further recommend:

1. that this system be used in the future because of the many benefits it encompasses and the low level of risk involved. Government will have to initiate new rules to allow this type of partnership to work in the future.
2. that the renewal of contracts for DLN and MHL continue until the project is completed as long as they are willing to provide labour at the same rates. It is our view that it would not make any sense to involve anyone new at this point.
3. a procedures manual of the processes under the new arrangement be drawn up to be used as a major subcontract project guide in the future.

Part 4

4.1. Overall Conclusion

How well projects are managed, and how well the related systems and processes function are important for a successful outcome. Taking into consideration the need for transparency and accountability in all activities, whilst ensuring increased economic activity on Montserrat is important. The issue of tendering for projects and the suggested recommendations in moving this project to phase 2 must be considered in terms of the risk(s) involved and the benefits that can be derived.

4.2. Management Response

The recommendations in the Report are acceptable. However, the Ministry would have to obtain a waiver from our standard procedures in order to implement the other phases without normal tenders and contracts.