

**Powys County Council  
Governance and Audit Committee Cover Report**

<b>Committee:</b>	Governance and Audit Committee
<b>Date:</b>	18 <sup>th</sup> April 2024
<b>Subject:</b>	Red Dragon SWAP Internal Audit Report

**1. Who will be the Lead Officer(s) / Lead Cabinet Member(s) presenting the report?**

<b>Name:</b>	<b>Role:</b>
Matt Perry	Chief Officer - Place
Andy Thompson	Interim Head of Housing

**2. Why is the Committee being asked to consider the subject?**

Following the request of Governance and Audit Committee, to review of the contract procurement and management of the Red Dragon Local Authority New Build scheme.

**3. Role of the Committee:**

**Governance and Audit Committee Terms of Reference:**

- Receive and review internal audit reports and ensure officers respond promptly to the findings. Where necessary recommendations to other committees and portfolio holders will be made, to ensure action plans are implemented.
- Where necessary ensure action is taken by officers to address those issues raised, and if necessary, recommendations to other committees and portfolio holders will be made to address findings and deliver clear conclusions.

**4. Key Questions:**

For information.

**Key Feeders (tick all that apply)**

Strategic Risk	X	Cabinet Work Programme	
Director / Head of Service Key Issue		External / Internal Inspection	X
Existing Commitment / Annual Report		Performance / Finance Issue	
Suggestion from Public		Referral from Council / Committee	X
Corporate and Strategic Equality Plan		Impacting Public / Other Services	
Service Integrated Business Plan		Statutory Duty	X

Suggestion from Members			
Partnerships	X		

**Key Impact (tick all that apply)**

Policy Review		Performance	X
Informing Policy Development		Evidence Gathering	
Risk	X	Corporate and Strategic Equality Plan	
Service Integrated Business Plan		Partnerships	X
Pre-Decision Scrutiny		Finance / Budget	X
Climate / Nature Emergencies			

# CYNGOR SIR POWYS COUNTY COUNCIL

## Governance and Audit Committee

April 18<sup>th</sup>, 2024

**Report Author:** Matt Perry (Chief Officer – Place)

**Lead Officer:** Andy Thompson (Interim Head of Housing)

**Report Title:** Red Dragon Audit Report

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**Report For:** Decision

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### 1. Purpose

- 1.1 This report provides an overview of an audit undertaken by SWAP<sup>1</sup> into the performance and effectiveness of contract management processes for the Red Dragon housing development project. The audit focused specifically on the use of Project Bank Accounts (PBA) for this contract.
- 1.2 The audit report, with an Action Plan, is attached to this report as Appendix A. The overall assessment of the audit is ‘medium’, noting the risk of “Reputational damage and financial commitment due to the lack of contract management and commissioning”.
- 1.3 The audit highlighted gaps in contract management, guidance, skills, communication gaps between departments, and delays in setting up the Project Bank Account (PBA). It emphasised the need for implementing formal documentation of contingency plans, using a central storage system, and improving communication channels to strengthen collaboration across departments. Overall, the audit notes a need for continuous improvement in contract management practices for the Council to achieve successful project outcomes and mitigate risks effectively.
- 1.4 Although the findings and agreed actions within this audit are in relation to the Red Dragon Council-house building project, they are relevant to all Council services letting, managing and administering contracts.

### 2. Background

- 2.1 The Council’s Governance and Audit Committee has raised concerns about the way the Council managed and administered the contract for the Red Dragon Council-house building project. R.L. Davies & Son Ltd, the lead contractor for the scheme for which works began in 2021 went into administration in February 2023. The scheme was not complete with outstanding works undertaken by the Housing Service’s in-house workforce. The scheme was officially opened in September 2023.
- 2.2 The financial collapse of R.L. Davies & Son Ltd meant that sub-contractors and suppliers working for the company, including any based in Powys, to whom payments had not been made for works or materials supplied, were unable to be paid once the company was in administration.

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<sup>1</sup> SWAP is the biggest local government internal audit partnership in England and Wales.

- 2.3 The Council advised any sub-contractors or suppliers who considered themselves to be owed money for services rendered to R.L. Davies & Son Ltd to lodge all such claims with the administrators, BDO LLP. This advice was given because there is no liability on the part of the Council to pay sub-contractors or suppliers for the cost of work and materials for which the Council has already made payment to the lead contractor prior to it going into administration. All claims submitted to the administrators of a company in administration are checked and then if valid, quantified, by the administrator. Claims can be submitted at any time until such time as the administration process is completed.
- 2.4 PBAs are ring-fenced accounts from which payments are made directly and simultaneously on behalf of the client to all parties in a project's construction supply chain. Funds in the account can only be paid to beneficiaries, that is, members of the supply chain named in the account (the lead contractor and supply chain members). The aim of a PBA is to speed up payments to all members of the supply chain to reduce cash flow problems for the supply chain. The account is held in the names of trustees (the client and lead contractor for dual authority accounts or the lead contractor for single authority accounts). This trustee status means that in the case of insolvency amounts payable to the supply chain are secure and can only be paid to them.
- 2.5 A PBA does not affect procedures for valuing and certifying payments and does not remove the lead contractor's responsibility for selecting and managing the supply chain. Not all banks offer PBAs for construction projects.
- 2.6 PBAs only protect those sub-contractors who agree to participate in the PBA pertaining to the project on which they are working. There is no legal requirement for sub-contractors to participate in a PBA. Businesses providing services to a lead contractor have other ways to protect themselves in the event of the failure of a client. This includes taking out Trade Credit Insurance or negotiating appropriate payment terms to make sure that the suppliers never extend to the lead contractor more credit than the supplying company deems to be a reasonable level of risk to the business.
- 2.7 Suppliers are recommended to participate in PBAs where they are available. PBAs are not as yet a mandatory or legal requirement although in December 2017, the Welsh Government announced that it would use PBAs on all building projects over £2,000,000 procured by government bodies from January 2018. In 2021 research by Actuate UK revealed that the Welsh Government had thirty-nine projects eligible to use PBAs with a total value of £873,800,000 but only three of these thirty-nine projects had in practice used PBAs.
- 2.8 In June 2023, the UK Government blocked an amendment to the Procurement Act 2023 that would have made PBAs mandatory for all construction projects valued at over £2,000,000.
- 2.9 The contract for the Red Dragon project had specified the need for a PBA to be in place but this did not happen. The Committee felt this may have contributed to issues with subcontractor payments towards the end of the

scheme. The Committee therefore requested a piece of internal audit work to be commissioned to help understand why the PBA had not been put in place.

### 3. Advice

3.1 The audit by SWAP of the Red Dragon project highlighted a number of concerns about the management and administration of the contract, with a particular focus as requested by the Governance and Audit Committee on PBAs. These have been considered by a team of officers from Housing Services, Financial Services, Commercial Services and Legal Services and working with SWAP, an Action Plan has been prepared to address and resolve the issues raised in the audit.

3.3.1 A summary of the principal concerns and the agreed actions are presented below.

#### 3.4 Contract and Contract Management

3.4.1 The internal contract distribution process lacked clarity, hindering the understanding of responsibilities.

- *Action: Signed contracts (both those under seal and not under seal) and supporting documentation to be electronically scanned and distributed to:*
  - *Head of Legal Services.*
  - *Service Area Contract Manager (e.g. Housing Development Lead Development Officer).*
  - *Commercial Services.*
  - *Financial Services.*
  - *Final hard copy to be sent to Legal Services and to be stored in a safe and accessible location. (Service Area Contract Manager and Legal Services).*
- *Action: Options paper to be submitted to Senior Leadership Team (SLT) for consideration of the Council installing a centralised electronic contract management system for all contracts and any related contract addendums. (Commercial Services).*

#### 3.5 Guidance, Training and Skills – Contract Management Framework

3.4.1 Absence of clear contract monitoring guidance hindered contract management and consistency.

- *Action: Develop and circulate process chart setting out service/function responsibilities throughout the commercial lifecycle of the contract. (Commercial Services).*
- *Action: Develop and circulate a top tips contract management guidance and checklist of what is need and when for contract managers including on supplier practices that could highlight concerns with supplier's financial standing. (Commercial Services).*

#### 3.5 Guidance, Training and Skills – Making sure that subcontractors are paid.

3.5.1 The process for creating the project bank account and communicating its benefits to subcontractors should have been readily available to expedite the process.

- *Action: A report to be presented to CLT by the end of Q1 2024-2025 with recommendations for the requirements, expectations and thresholds for*

*consideration of the use of PBAs in contracts let by the Council. (Commercial Services).*

- *Action: Guidance for subcontractors is now in place developed by the Housing Development Team and Commercial Services and included in tender pack where applicable. (Housing Services – Action Completed).*

### 3.5.2 Officers lacked comprehensive training.

- *Action: Implement contract management training programme. (Housing Services; Commercial Services).*
- *Action: All contract managers responsible for contracts should be suitably skilled, experienced, and trained in the forms of contract that they are expected to deliver. (Commercial Services).*
- *Action: Strategic Contract Management Officer to be recruited, to provide contract management support advice, challenge, and expertise. (Commercial Services.)*

### 3.5.3 Contract Manager's skills and experience requirements need to be reflected in the Job Description and Person Specification for all officers whose work will include acting as Contract Manager.

- *Action: Report to be submitted to SLT outlining recommendations to make sure officers with contract management responsibilities have the relevant experience and qualifications for contract management (Commercial Services).*

### 3.5.4 Progress toward improving contract management processes is not yet implemented.

- *Action: Implement Contract Management Framework (CMF) which applies a risk-based approach (with standard processes and appropriate key performance indicators) to contract management. (Commercial Services).*

## 3.6 Payments and the Project Bank Account

### 3.6.1 Early action in response to warnings of financial pressure on the main contractor

- *Action: Supplier Financial Risk Mitigation introduced in December 2022. (Commercial Services – Action Complete).*
- *Action: Housing Development Team to use periodic progress meetings as mechanism for raising financial aspects of the project including payments and valuations. (Housing Services – Action Complete).*

### 3.6.2 Clear process needs for the implementation of the newly introduced contractual clauses in section 2.42 of the Schedule of Amendments to the 'JCT Design & Build Contract'<sup>2</sup>. (put in place to ensure due process and that subcontractors are paid and in a timely manner until such time as a PBA can be created).

- *Action: Standardised process to be established for the Housing Development Team in applying the newly introduced contractual clauses in section 2.42 of the Schedule of Amendments to the 'JCT Design & Build Contract'. (Housing Services in collaboration with Commercial Services).*

## 3.7 Oversight and Data Management

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<sup>2</sup> The 'JCT Design and Build Contract' is designed for construction projects where the contractor carries out both the design and the construction work. JCT is a construction industry partnership which produces standard forms of construction contract, guidance notes and other standard forms of documentation for use by the construction industry.

- 3.7.1 Make sure appropriate oversight takes place with important decisions being documented.
- *Action: Project issues for senior decision are taken to the New Development Project Board in a Project Board Report. Decisions are clearly recorded in the minutes. A formal sign-off of the report itself is signed by Board Members. (Housing Services – Action Complete).*
  - *Action: Any financial issues impacting upon capital funding to be reported up to Head of Service and Director, through to the Capital Oversight Board. (Head of Housing).*

- 3.7.2 Lack of a centralised data management system and document repository hindered transparency and awareness of project issues for decision-makers.
- *Action: Centralised corporate electronic interactive contract management system (in conjunction with a centralised Hard Copy document management system) to be recommended to SLT. (Commercial Services).*

### 3.8 Risk Management

- 3.8.1 Insufficient oversight of risks and warning signs throughout the project.
- *Action: The Contract Manager from the Service Area leading the contract and the Financial Reporting and Policy Accountant to register to monitor Companies House filing updates. Dun & Bradstreet reports to be commissioned for new annual account filings. Where higher than average risks are identified, future actions are agreed. (Service Area Contract Manager; Financial Services).*
  - *Action: Introduction of Risk Registers for all projects which collaborate across key departments. (Housing Services with Legal, Financial and Commercial Services).*

### 3.9 Culture

- 3.9.1 Improved communication across key departments.
- *Action: Centralised contract management system/database to be recommended to SLT. (Commercial Services).*
  - *Action: Council-wide quarterly operational level Commercial Collaboration Community to share knowledge and experiences and inform commercial improvement. (Commercial Services.)*
- 3.10 Effective monitoring of the Action Plan will help make sure the improvements needed are put into effect. In view of the whole-council impact of being able to undertake effective and efficient contract management and, where appropriate, oversee the use of PBAs, it is recommended that progress on the Action Plan is reported monthly to the Commercial Performance and Risk Board and quarterly to the Senior and Corporate Leadership Teams.

## 4. Resource Implications

- 4.1 The anticipated Final Account in respect of the Red Dragon scheme at the time R.L. Davies went into administration was £3,674,555, of which £3,540,989 had been paid by the Council.
- 4.2 Not all of the actions highlighted in this report, informed by the SWAP audit of the Red Dragon construction project have resource implications, as they relate to a more effective use of existing capacity and capability.

- 4.3 The main resource implication arising from the audit will be a recommendation for the Council to invest in a centralised, all-service, interactive data management system and document repository. The report setting out the recommendation will include cost estimates, both for initial installation and then ongoing operational costs and resource requirements. The engagement of the Council's ICT team will be a critical contribution towards making taking forward this recommendation a success.
- 4.4 The Council's Deputy Head of Finance acknowledges the report and can confirm that many of the actions set out can be accommodated within existing staffing or financial resources. Detailed consideration of the recommended investment in a centralised contract management system will be the subject of a separate report. Any additional funding required would need to be identified through the budget setting process and included within the Finance Resource Model (FRM) for approval.
- 4.5 The Council's S.151 Officer has considered this report and acknowledges the actions that are proposed to address the audit concerns and supports the recommendation. It must be noted that the use of PBAs may reduce but not eliminate risk, as we know sub-contractors do not always chose to participate in this payment approach. Powys has been working with other local authorities and housing associations to work with participating banks to speed up the PBA set up process and keep a close eye on contractor solvency.

## **5. Legal implications**

- 5.1 Legal Services has commented: "The recommendations and the action plan can be supported from a legal point of view".
- 5.2. The Head of Legal Services and the Monitoring Officer has commented as follows: "I note the legal comment and support the recommendations and Action Plan "

## **6. Climate Change & Nature Implications**

- 6.1. The recommendations and actions set out in this report will have no impact on the climate or the natural world.

## **7. Data Protection**

- 7.1 The recommendations and actions set out in this report do not involves the processing of personal data.

## **8. Comment from local Member(s)**

- 8.1 The recommendations and actions set out in this report will affect all wards of the Council.

## **9. Impact Assessment**

- 9.1 Each contract let by the Council will be considered as part of the Impact Assessments undertaken, where necessary, by each service for the activities related to its contracts.

## **10. Recommendation**

10.1 It is recommended that:

10.1.1 The Committee notes and provides comments on the Action Plan.

10.1.2 Progress on the Action Plan, set out as part of the SWAP Audit Report on the Red Dragon construction project is reported monthly by Commercial Services to the Council's Commercial Performance and Risk Board and quarterly to the Senior and Corporate Leadership Teams.

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