

REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER  
SECTION 22(3) OF THE PUBLIC FINANCE AND  
ACCOUNTABILITY (SCOTLAND) ACT 2000

**THE 2001/02 AUDIT OF THE SCOTTISH PARLIAMENTARY  
CORPORATE BODY**

---

I have audited the accounts of the Scottish Parliamentary Corporate Body for the year ended 31 March 2002. I am satisfied with the presentation and regularity of the accounts, and the report detailing my opinion on the accounts is unqualified.

I have prepared this additional report to inform Parliament about my findings concerning a £7.2 million contract with a supplier (Flour City) for part of the new Parliament building, which the Corporate Body terminated in October 2001. I also describe other contract management issues, which are related to my audit of the 2001/02 accounts. I submit this report in terms of sub-section 22(3) of the Public Finance and Accountability (Scotland) Act 2000, together with the accounts and the report of my audit, which I have prepared under sub-section 22(2) of the Act.

**AUDIT FINDINGS ON THE FLOUR CITY CONTRACT**

**Background - the Holyrood building project**

1. The Holyrood project is a prestigious construction project aimed at creating a building of international significance to house the Parliament. In September 2000 I published my report<sup>1</sup> on the management of the project, including recommendations to improve the management of the project. In December 2000 the Scottish Parliament's Audit Committee published its report<sup>2</sup> on the project with further recommendations. The Corporate Body accepted these recommendations to strengthen and reinforce the management and control of this challenging and demanding project.
2. Project management within the Corporate Body constitutes the Clerk and Principal Accountable Officer of the Scottish Parliament and the project team under the leadership of the project director, who reports to the Clerk.
3. The Holyrood Progress Group, established in June 2000 following a Resolution of the Parliament, provides high-level, authoritative advice on technical, professional and administrative issues relating to the project.
4. The project is being delivered under a system of construction management. Under this the Corporate Body remains accountable for the management of the project while contracting with a construction

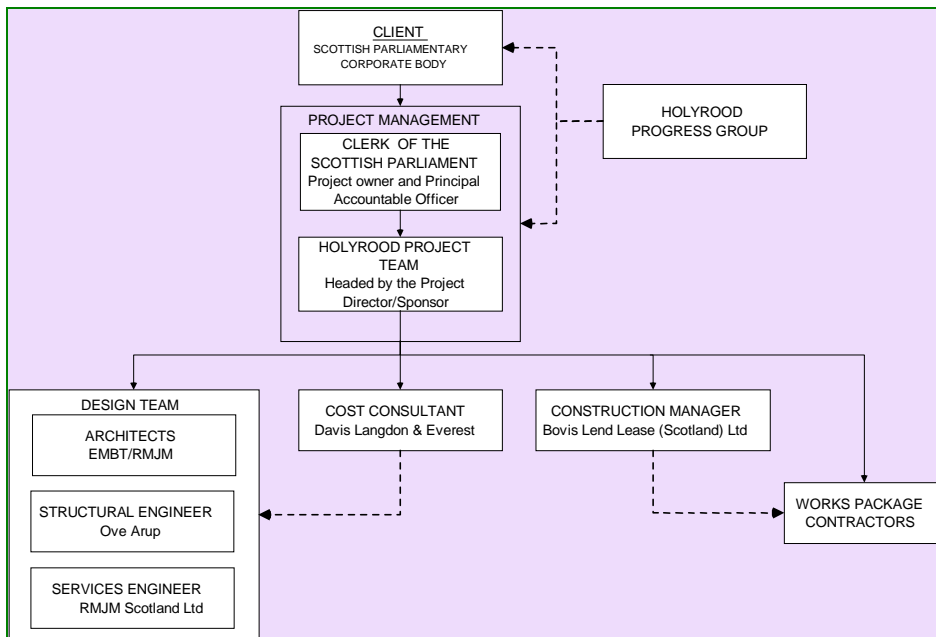
---

<sup>1</sup> The new Scottish Parliament building: An examination of the management of the Holyrood Project

<sup>2</sup> 6th Report 2000: The New Scottish Parliament Building

manager (Bovis Lend Lease (Scotland) Ltd) to oversee and manage the construction process. As the construction manager, Bovis manage and co-ordinate the services provided by the design team and the organisation and supervision of the site. In conjunction with the design team Bovis must also administer, prepare and implement all construction works contracts on behalf of the Corporate Body, although the Corporate Body remains the employer for all contracts (Exhibit 1).

Exhibit 1: Holyrood project organisation



**The client**

The *client* owns the project and the investment decisions involved. Until 1 June 1999 the client was the Secretary of State for Scotland. On 1 June 1999 client responsibility transferred to the Scottish Parliamentary Corporate Body.

From June 2000 the Holyrood Progress Group have assisted the Corporate Body in their functions as client.

**Project management**

The *project owner* and the *project team* together constitute project management.

The Clerk and Principal Accountable Officer of the Scottish Parliament is the *project owner*, the most senior official responsible since June 1999 for the successful delivery of the project to the client. The Clerk is also responsible for ensuring that the Parliament and the Corporate Body receive sufficient, informed and independent advice about the project.

The *project team*, including civil servants and private sector appointees on secondment to the team, is responsible through the project director to the project owner for managing and delivering the project.

Source: Audit Scotland

**The design team**

EMBT/RMJM Limited has lead responsibility for the design of the new building. They were appointed in July 1998 after a competition.

The *other members of the design team* are Ove Arup and Partners and RMJM Scotland Limited, and are responsible for structural and mechanical and electrical engineering services. They were chosen by the architects and approved and appointed by project management in 1998.

**The construction manager**

The *construction manager* is Bovis Lend Lease (Scotland) Limited, appointed in January 1999 after a competition. In summary Bovis oversees and manages the design and construction process on behalf of the client who remains the employer for all contracts. Bovis provide a service for the client side and is independent of the contractors responsible for constructing the building.

**The cost consultant**

The *cost consultant* is Davis Langdon & Everest. They advise and act for project management and liaise with the design team on cost matters. Project management appointed them in April 1998 after a competition.

5. The project is large and complex and within the currently estimated project cost of £307 million (including risk), almost £230 million relates to expenditure on works contracts, which have been divided into 83 individual works packages. The Corporate Body budgeted £84 million capital spend during 2001/02 but due largely to delays on the Holyrood project, some £40 million was actually spent.

### The Flour City contract

6. In August 2000 the Corporate Body sought tenders for the contract for the cladding and windows package for the MSP block of the Holyrood building (Exhibit 2).

#### Exhibit 2: MSP building - cladding and windows package

This package included completing the design prepared by the design team and the manufacture, supply and installation of external envelope cladding to the MSP building of the Scottish Parliament. This involves manufacturing and installing a complex series of granite, slate and stainless steel cladding panels fixed back to the structure directly, or through a secondary support structure as appropriate.

The package also includes completing the design prepared by the architects and manufacturing, supplying and installing various forms of window for the same building. Again this work involves complex features such as recessed vent windows and bay windows.

Tenders were required by September later extended to October 2000 and the works were to be completed in phases over the period January 2001 to January 2002.

Source: Audit Scotland

7. Despite efforts to promote a good response, there proved to be little interest from the market for the competition for these works.
  - After advertising and in accordance with procurement regulations submissions were sought from firms wishing to be considered for inclusion on a shortlist for tendering. Originally 36 suppliers including specialist cladding contractors expressed an interest or were approached as potential bidders before or during the pre-tender assessment and evaluation period (April to June 2000). But in the event only five contractors proved willing to make the necessary submission to be considered for shortlisting.
  - In the subsequent tender round (August to October 2000) of five firms invited only two submitted bids.
  - The low level of interest was due to the complexity of the design combining a variety of materials and systems.
8. Neither of the two tenders in October 2000 fully met the tender requirements. Both tenderers subsequently provided revised and substantially compliant bids. But these were priced at some £10.2 million and £10.3 million, substantially higher (55-56%) than the approved pre-tender cost allowance (£6.6 million).
9. Following legal advice on the proper procedure, both tenderers were invited to negotiate a price for the work consistent with the available budget. Though one tenderer declined this invitation the other (which had submitted the lower bid) was prepared to negotiate. The remaining tenderer was *Flour City Architectural Metals (UK) Ltd* (Flour City), which is a UK registered member of the group of

companies owned by *Flour City International Inc* registered in the United States<sup>3</sup>.

10. Following the tender stage and immediate post tender negotiations it was almost eight months before the Corporate Body and Flour City agreed and executed the entire formal trade contract for the works.
  - In December 2000 the Corporate Body issued a limited, interim contract in the form of a “letter of intent” (Exhibit 3) to Flour City authorising it to provide design services within a £0.25 million expenditure limit (to be set off against the contract sum to be agreed). This was to allow design development to achieve savings within the works package consistent with the available budget.
  - In January 2001 the Corporate Body issued a second, more extensive interim contract to Flour City. By then negotiation had produced an agreed contract sum of some £7.2 million on a revised if not completely agreed package of works. The expected contract sum was below the revised cost plan allowance of some £7.4 million for the work, which project management had meanwhile approved.
  - The use of these interim contracts enabled works to commence as soon as possible independently of negotiation and agreement of the full trade contract. This was to maintain the works programme and avoid consequential delays to subsequent packages.
  - Eventually the Corporate Body and Flour City agreed and executed the entire formal trade contract for the works in August 2001.

Exhibit 3: Letters of intent and interim contracts

In construction projects a letter of intent or an interim contract may be used as a stopgap measure to facilitate commencement of works, pending negotiation and agreement of the full, definitive trade contract. They are an inherently risky arrangement for both parties because agreeing full design details and other contract terms and conditions may take many weeks or months after a letter or interim contract has been issued; yet all the while works are proceeding with scope for variation and no guarantee of eventual agreement on any liability. In the case of Flour City, the rights and obligations of both parties were set out in a formal contract and all payments were made in accordance with the terms of that contract.

Source: Audit Scotland

11. Flour City started work immediately under the first interim contract in December 2000 but by August 2001, when the final trade contract was executed, serious doubts had emerged about its ability to perform the works. As time passed and grounds for concern over the contractor’s performance became apparent, efforts continued to agree

<sup>3</sup> In August 2001 *Flour City International Inc*, registered in the United States, owned or controlled 11 companies, including *Flour City Architectural Metals (Pacific)*, registered in the British Virgin Islands, which in turn owned *Flour City Architectural Metals (UK) Ltd*, registered in the UK

the full contract, in part to protect the Corporate Body's position in the event that Flour City could not complete the works satisfactorily.

- In May 2001 project management sought and received assurances from Flour City that the contract would be agreed that month. It questioned the performance of Flour City and whether the company was capable of committing the necessary resources to the project and ensuring a satisfactory outcome.
  - In July 2001, when the full contract was about to be signed, Flour City was between 13 and 15 weeks behind schedule on the contract works, with delays of 20 weeks on some window elements. Approximately 90% of the necessary design work was considered complete but little progress appeared to have been made in the manufacturing process thus severely delaying on site installation.
12. According to Flour City, the principal reason for this delay was that it had entered into sub-contracts with suppliers on the basis that it would provide advance payments for the design and manufacturing process or production of the raw materials. Manufacturing and production fell behind schedule because Flour City had not made any of the critical advance payments because of wider cash flow difficulties within the group of companies of which it was a member.

### **Termination of the Flour City contract and associated costs**

13. In August Flour City was assessed to be 24 weeks behind schedule and project management issued six contractual notices of failure in specified areas. In September project management issued a further notice, which required remedy by Flour City or it would terminate the contract. This included the requirement to provide a performance bond (Exhibit 4 on next page) for 15% of the contract value in accordance with the contract. Though Flour City did provide a parent company guarantee to the Corporate Body on 4 October 2001 it failed to provide the bond within the deadline of 12 October 2001 and the Corporate Body terminated its contract.

### Performance bonds

A performance bond is a legally enforceable financial guarantee given by a third party (the guarantor) to a purchaser (the client) to guarantee the obligations of a supplier of goods, works or services (the contractor) under a contract. The guarantor agrees to pay the client a sum of money if the contractor defaults on its obligations. The purpose of requiring a bond is to help the client meet the extra expenses to remedy the default and/or complete the contract.

A performance bond is usually provided at contract award, for an agreed percentage of the total contract value (normally 10%). It will not of itself ensure that contracts are carried out efficiently and to time, but it will be one of a number of commercial pressures on the contractor to perform well. A performance bond can provide some compensation if the contractor defaults on its obligations.

Clients should seek appropriate professional and legal advice on the use, choice, and drafting of bonds for a particular contract.

Bonds are not always necessary and are no substitute for considered judgements about the risks of a particular contract and the capabilities and financial resources of the available contractors. A decision to require a bond must be part of an overall approach to risk management and should take account of available measures to reduce the risk of default, including a proper pre-qualification of tenderers. Clients need to exercise careful judgement in assessing the costs and benefits of using bonds, many of which may not be easily quantifiable.

### Parent Company Guarantees

A parent company guarantee is where the parent (or holding) company guarantees the proper performance of a contract by one of its subsidiaries (the contractor). The liability can take several forms including a financial guarantee of completion of the project itself or the employment of another contractor to complete the project.

Clients should be aware when vetting the contractor that a parent company guarantee is only as good as the parent (or holding) company itself. If the financial position of the holding company is inadequate, then the guarantee should be given by the ultimate parent company, if this is justified by its own financial standing.

Source: Edited extracts from Central Unit on Procurement Guidance Note 48: *Bonds and Guarantees* (HM Treasury 1994)

14. These developments coincided with a wider picture of increasing financial difficulty for the group of companies of which Flour City was a member. Flour City's only other major project was at Canary Wharf in London and the client terminated this contract due to alleged under performance at the end of August 2001. At the same time, the US holding company Flour City International Inc announced the termination of several contracts based on alleged performance defaults triggering an immediate collapse in its share price. In September 2001 Flour City acknowledged to project management a decline of the group over the previous 12 months, which it attributed to poor financial management combined with an attempt to expand too rapidly, the slow recovery of moneys owing on projects in progress and particular budget overruns on major projects in the US and elsewhere.
15. The compulsory winding-up of Flour City (as a UK registered company) for insolvency was confirmed by court order in October 2001. Flour City International Inc, the original holding company registered in the United States, remains active.
16. Between February and July 2001 the Corporate Body authorised six payments to Flour City totalling some £854,000. Two further claims that Flour City submitted in July and August 2001 were withheld

because of non-delivery of elements of the contract. All payments followed claims Flour City had made under the two interim contracts and they were properly made in accordance with standard payment authorisation procedures. Although Flour City had made little progress with construction on site the payments related mainly to preliminary works including completion of the design work, which was a necessary and integral part of the works package. The Corporate Body now owns Flour City's design work and drawings and has used them used to progress this works package. Flour City had produced 456 design drawings for the MSP Block, some 70% of the expected total for the contract.

17. Project management's estimate of its direct extra costs arising since termination of Flour City's contract and re-tendering of the work is some £3.9 million (Exhibit 5). In addition there are consequential but unquantifiable costs associated with the impact of delay in completion of the cladding and windows package on the programme for and therefore the cost of other works packages. The Corporate Body is currently investigating the feasibility of action to seek recovery of its additional costs. The extent to which the taxpayer will ultimately bear these costs cannot yet be determined.

**Exhibit 5: Extra costs arising after termination of Flour City's contract**

Net payments to Flour City		£854,000
Estimated additional costs compared to original contract sum		
East stainless steel vent pods	£1,729,000	
Bay windows	£937,000	
East elevation support steelwork	£497,000	
Window Units	£120,000	
MSP roofing	£100,000	£3,383,000
Less forecast savings in other areas		
Stone Cladding	-£326,000	
Timber and pre-cast mullions, louvres and stone panels	-£61,000	-£387,000
<b>Total additional costs</b>		<b>£3,850,000</b>

Notes: All figures exclude VAT

The extra costs include some £1 million for additional blast proofing measures, which is an additional requirement identified after the contract with Flour City had been terminated.

Source: Corporate Body

## CONCERNS ARISING FROM THE AUDIT FINDINGS ON THE FLOUR CITY CONTRACT

### Contract selection and tendering

18. The underlying objective of shortlisting tenderers is to promote best value, and to ensure that only capable suppliers are invited to tender and are appointed. It is not clear that the initial selection procedure was effective in this case.
19. The construction manager was responsible for evaluating submissions from potential bidders, and selecting those capable and best qualified to be invited to tender, subject to project management approval. In accordance with procurement regulations the necessary criteria for the assessment of tenders were specified and advertised



before the tender competition. However, while the construction manager had devised suitable guidance to draw up a list of companies to be invited to tender, in practice the application of this guidance was not fully systematic and objective.

- Although the construction manager implemented an objective scoring system to assess suppliers, there was no minimum standard to determine each applicant's ability to undertake the work. At this initial shortlisting stage Flour City was scored at 169 points compared to a maximum available score of 540 and an average score of 273 by all applicants assessed for this contract.
- Flour City scored poorly partly due to their limited track record and their inability to demonstrate capability with regard to quality or Health & Safety standards. However a relevant factor was the holding company's international standing and conduct and other significant contracts in other countries. An action plan for improving quality and Health & Safety aspects was therefore developed for application if Flour City was successful. Thus Flour City was accepted as a tenderer not because it showed clear evidence of possessing the necessary attributes but rather that it showed the potential to develop them.
- The construction manager operated a procurement guideline that the value of any contract award should not exceed 33% of the applicant's turnover. Flour City satisfied the 33% test on the basis of £40 million turnover that its pre-tender application reported as the turnover of its US holding company. When audited financial statements for the 1999 financial year became available later they indicated turnover of \$44 million (i.e. nearer to £30 million), albeit the test was still satisfied. There was no other specific, documented assessment of Flour City's financial capability to complete the contract, despite the requirement for all applicants to provide three years' financial performance data for evaluation for this purpose. Two other companies that were included on the shortlist of five tenderers did not meet the 33% of turnover test and none of the companies provided all the required financial performance data.
- Project management considers that these departures from the guidance were justified in the interests of encouraging competition for this package.

### **Contract award and management**

20. In awarding and managing the Flour City contract the Corporate Body relied on interim contracts and did not obtain its own legal advice on certain aspects. There were also questions about the thoroughness of the financial assessment of Flour City at key stages.



### Interim contracts

21. Following the tender stage the Corporate Body and Flour City entered into two interim contracts in December 2000 and January 2001. It was almost eight months before the Corporate Body and Flour City agreed the entire formal trade contract for the works in August 2001.
22. While interim contracts may be a necessary expedient they must always be used with caution. A clear view on the risks involved needs to be adopted in individual cases and legal advice should be obtained before any interim contract is implemented. The two interim contracts the Corporate Body awarded to Flour City in December 2000 and January 2001 had two unsatisfactory features.
  - Both interim contracts were based on wording devised by the construction manager's legal advisors. But project management did not obtain advice from the Parliament's own legal directorate prior to issuing either interim contract, despite the construction manager's recommendation to this effect.
  - The tender authorisation document approved in January 2001 specified the requirement for Flour City to provide both a performance bond and a parent company guarantee. However, while the second interim contract issued in January 2001 provided for Flour City to provide a parent company guarantee on request, it did not contain any requirement for a performance bond. This was a serious omission because, taken with Flour City's failure to deliver a performance bond under the full trade contract issued in August 2001, it left no simple remedy for the Corporate Body to recover part of the extra expense required to complete the contract<sup>4</sup>.
23. After the issue of the second interim contract in January 2001, despite efforts to secure earlier agreement, the construction manager did not secure Flour City's acceptance of the full trade contract until July 2001 and the contract was finally executed in August 2001.

### Financial assessment

24. There were three occasions when Flour City's financial standing should have been considered:
  - Pre-tender assessment and evaluation (April to June 2000).
  - Interim contract award, in particular the issue of the second interim contract in January 2001.
  - Award of the full and final trade contract on 1 August 2001.

---

<sup>4</sup> Flour City did provide a parent company guarantee but only in October 2001, eight months after the second interim contract that required it. Project management is taking legal advice on the enforceability of the parent company guarantee. The guarantee's value depends on the financial position of the parent company, which may not be adequate to meet any call from a guarantee.

25. The appraisal of Flour City's financial standing at these key stages was not sufficiently thorough.
- During the pre-tender period, reliance was placed on information from Flour City on the turnover and general standing of the holding company.
  - On 25 January 2001 – the day just before the award of the second interim contract – Flour City sought agreement to an advance payment of £2 million of the contract sum. The request was not accepted. Although the request alerted project management and the construction manager to possible difficulties with Flour City's financial capacity, it was not until March 2001 that Flour City was asked to confirm that it was not “experiencing difficulties obtaining the usual level of credit required within the industry”.
  - Shortly before the execution of the full trade contract in August 2001 Flour City's underperformance on the contract was known. In a report of 27 July 2001 project management noted that, *“behaviours such as applications for advance payments, non-payment of suppliers and ... aggressive pursuit of early payment of valuations have caused some speculation over (Flour City's) on-going financial status.”* However project management made no further inquiries regarding Flour City's financial capacity to complete the work before approving the full trade contract.
26. As a recently formed UK company Flour City had no track record as a supplier in its own right and its capability to perform the contract was based on the reputation and record of its overseas holding company. Taking into account the subsidiary company's unproven ability there should have been explicit consideration of the particular risks represented by its status. In particular, at some point before the appointment, it would have been prudent to have made more thorough inquiries of Flour City and its bankers concerning its financial capacity to complete the contract.

## WIDER CONTRACT MANAGEMENT ISSUES

27. Because of the concerns arising from the review of the Flour City contract, Audit Scotland examined on my behalf other works package contracts that had been let as part of the overall Holyrood project up to 31 January 2002. The review showed that at the time of the audit examination there were significant ongoing risks in two areas: the use of interim contracts; and the securing of performance bonds and parent company guarantees.
28. My findings are detailed below. In September 2002 I informed the Accountable Officer of the Corporate Body of these risks. In response he accepted that some interim contracts were allowed to continue long after trade contracts should have been finalised and that there were significant delays in obtaining some performance bonds and parent company guarantees. Fortunately, excepting the

Flour City case, none of the risks implicit in this situation appears to have crystallised. Following his further review, the Accountable Officer has taken action to ensure that where necessary full contracts, bonds and guarantees have been put in place to prevent similar risks arising again.

## Findings on interim contracts

### Risks

29. The review of other works package contracts placed up to 31 January 2002 found, in respect of interim contracts:
  - Of the 36 works contracts packages where a bid had been approved, 23 operated on interim contracts in the form of letters of intent.
  - Some £35.2 million of payments had been made for works packages operating at some time under interim contracts.
  - Of this amount, £28.6 million had been paid to contractors operating solely under interim contracts. These contractors had operated solely on interim contracts for an average of 12 months with periods ranging from 2 months to 28 months.
  - The balance of some £6 million had been paid under interim contracts to contractors who have subsequently transferred to a full trade contract. These contractors had operated under interim contracts for an average of 10 months with periods ranging from 2 months to 24 months.
  - Twelve trade contract packages had operated under formal trade contract conditions from the outset and only some £0.6 million had been paid to contractors operating exclusively under formal trade contract arrangements at the time of the review.
30. Between 31 January and 30 September 2002 the Corporate Body has placed another 20 trade contracts, of which eight had operated initially on an interim contract.

### Project management response

31. Project management consider that, because of the construction management procurement route adopted on the Holyrood project, interim contracts have had to be used in many instances. Construction management has the benefit that, by dividing the project into discrete packages, building work can proceed on any one package whilst design of any other is completed, with an overall saving in time. But it is an inherently risky approach because the co-ordination of the work is complex, and to meet the programme, tender action has been taken before design work has been finalised, in some cases within individual packages of work. In these circumstances, it may be neither in the Corporate Body's or its suppliers' interests to enter into a formal trade contract before key elements of the package are resolved. To delay until designs were finalised would in project management's view have been

catastrophic for the programme and would have entailed substantial additional costs.

32. With 83 discrete works packages, project management considers that the financial and operational risks of using interim contracts were considerably less than the risks of delay. Nevertheless project management accepts that some interim contracts were allowed to continue when trade contracts could and should have been finalised. In the light of the audit findings and its own subsequent review project management has now subsumed all interim contracts into formal trade contracts.
33. Project management's review identified 21 interim contracts that had initially operated in the form of letters of intent. Their analysis showed that:
  - Eleven letters of intent were used where there was insufficient design information or progress to allow a full contract to be finalised. Project management consider that eight of these were subsequently finalised within a reasonable period.
  - Four letters of intent were used where it was in the interest of the tender price and/ or technical development of the package for the supplier to be involved in developing the design prior to the completion of the full trade contract. All of these were finalised when full design information became available.
  - Six letters of intent were used for investigation and temporary works where the extent of the contract very much depended on what was discovered. Five of these six contracts were finalised within between four and ten months, the sixth was taken into a full trade contract after 35 months.

## Findings on bonds and guarantees

### Risks

34. Bonds and guarantees are one of several commercial pressures that influence a contractor's performance. Other factors include monitoring on behalf of the client that work is being carried out to the required standard and on time, action to withhold payment for sub-standard work and the client's retention of 3% of all payments, which it releases only after it is satisfied that the contract has been performed to the required standard. As part of its service to project management, the construction manager recommends where it considers it is necessary to obtain performance bonds and parent company guarantees.
35. The review of other works package contracts placed up to 31 January 2002 found in respect of the use of performance bonds and parent company guarantees:
  - Of the 36 works packages where a bid had been approved, 20 were shown to require a performance bond. Of these only one had a performance bond in place.

- Of the 36 works packages where a bid had been approved, nine were shown to require a parent company guarantee (including some where a bond was also required). Of these only one had a parent company guarantee in place.
  - Delays in excess of 12 months have elapsed in securing performance bonds and parent company guarantees.
36. Between 31 January and 30 September 2002 the Corporate Body has placed another 20 trade contracts, of which 13 required a performance bond and nine a parent company guarantee.

#### Project management response

37. Project management considers that, while bonds and guarantees are useful “last resort” controls, the day-to-day monitoring of contractor performance is a more effective control. Project management points out that, excluding the Flour City case, none of the risks to which the Corporate Body was exposed by the failure to obtain the recommended securities has crystallised at this time. Nevertheless, project management accepts that it is prudent to seek these securities when recommended.
38. In the light of the audit findings project management has reviewed all contracts where bonds or guarantees were initially recommended and taken action to secure these, where justified.
- Of 33 contracts at September 2002 where the construction manager had recommended securing a performance bond the Corporate Body has now obtained 17.
  - The construction manager’s assessment is that of the 16 outstanding bonds at least eight are no longer required because the perceived risk has passed. Most of the remaining bonds required are for more recently awarded work.
  - Of 18 contracts at September 2002 where the construction manager had advised a parent company guarantee should be obtained the Corporate Body has now obtained four. In all other cases project management consider a guarantee may not be necessary taking into account the potential risk to the Corporate Body.

### CONCLUSIONS AND WIDER LESSONS

39. The main issue arising from the review of the Flour City and other works package contracts concerns the way in which risks associated with the contracts were managed.
40. In my opinion the award of the contract to Flour City was not improperly made, but there were deficiencies in the selection, award and management procedures for the contract, which exposed the Corporate Body to avoidable and significant risk. Some of these risks arose in relation to many other works contracts.

41. I raised my concerns with the Accountable Officer in September 2002. The Corporate Body has reacted positively by subsuming interim contracts into formal trade contracts and obtaining performance bonds and parent company guarantees for increased numbers of contracts. Fortunately only in the Flour City case have the risks implicit in this situation appeared to crystallise and the Corporate Body's action has reduced its exposure to risk.
42. The Corporate Body is currently investigating the feasibility of action to seek recovery of its additional costs in the Flour City case. The extent to which the taxpayer will ultimately bear such costs will not be known until the end of the overall Holyrood project.
43. The cost and programme risk associated with the 83 individual construction works packages for the Holyrood project is significant. In the light of the concerns identified, Audit Scotland will continue to monitor the management of the Holyrood project and its constituent contracts as part of the annual audit of the Corporate Body. In addition, the audit findings point to the following wider lessons for public bodies managing major construction projects.

1. Public bodies should ensure that procurement complies with established good practice (see Box). They should consider ways of actively obtaining assurance that good practice is being followed in this key area.

#### **Key principles of good practice for appointing contractors**

- Clear procedures should be followed that ensure fair and transparent competition in a single round of tendering consisting of one or more stages.
- The tender process should ensure receipt of compliant, competitive tenders.
- Tender lists should be compiled systematically from a number of qualified contractors.
- Tender lists should be as short as possible.
- Conditions should be the same for all tenderers.
- All parties should respect confidentiality.
- Sufficient time should be given for the preparation and evaluation of tenders.
- Sufficient information should be provided to enable the preparation of tenders.
- Tenders should be assessed and accepted on quality as well as price.
- Practices that avoid or discourage collusion should be followed.
- Tender prices should not change on an unaltered scope of works.
- Suites of contracts and standard unamended forms of contract from recognised bodies should be used where they are available.
- There should be a commitment to teamwork from all parties.

Source: *Code of Practice for the Selection of Main Contractors* Construction Industry Board 1997

2. Competition is central to effective procurement and value for money. Where the results of supplier shortlisting suggest there is a significant difficulty in attracting market interest public bodies should consider whether the intended competition remains viable and is likely to be effective. They should consider alternative strategies including repackaging the work into different components to promote more interest and a better response from the market.
3. Public bodies should be alert to the risks of extended contract negotiations following tender acceptance. As far as possible the procurement strategy for individual packages should be implemented to ensure that critical design details and conditions of contract are made available as part of, not after, the competition process.
4. Interim contracts may be a necessary expedient but they must always be used with caution and for the minimum period practicable. A clear view on the risks involved needs to be adopted in individual cases and legal advice should be obtained before any interim contract is implemented.
5. Where the risks of a particular contract are such that a bond or guarantee is considered necessary, it should be received immediately upon execution of the trade contract. It should be seen as a prerequisite for commencing work rather than a matter for subsequent negotiation. Any departure from this principle should be subject to additional monitoring and scrutiny.
6. Public bodies should set targets and monitor the procurement process to ensure that contract negotiations and the execution of a full trade contract are completed rapidly following tender acceptance.



Robert W Black  
Auditor General for Scotland  
18 December 2002