

RMCC Financial Audits

Background

The State Government is requiring its service delivery agencies to clearly demonstrate that their procurement arrangements are efficient and effective. The NSW Commission of Audit Report (May 2012) recommended that Roads and Maritime Services (RMS) investigate the opportunities to enhance the operation of Road Maintenance Council Contracts (RMCC).

RMS is currently reviewing its responsibilities for road maintenance delivery across NSW in order to ensure it continues to provide:

- Value for money through cost effective delivery
- Quality outcomes
- Work practices which meet Work, Health and Safety requirements
- Compliance with environmental standards
- Customer expectations

Analysis of council work proposals and Road Maintenance Annual Plans has identified a wide variation in the overhead costs attributed to RMCC prices.

Accordingly RMS determined that it would audit a sample group of RMCC councils State wide to determine the compliance of each councils' administration of the RMCC with the terms of the contract, the adequacy of their financial systems to capture information pertaining to RMCC reporting requirements and the adequacy and accuracy of financial records being maintained to support the expenditure incurred on RMS funded RMCC projects..

Contractual Context

Under the contract RMS and councils are committed to achieving best practice and value for money in the delivery of road maintenance in NSW.

In order to achieve best practice and value for money in the delivery of road maintenance RMS and the Council are committed *inter alia* to:

- a) increased price transparency in the delivery of road maintenance services;
- b) open, honest and good faith communications; and

- c) a focus on value for money in the delivery of road maintenance.

The RMCC removes councils' pricing risk for routine maintenance, incident response and some ordered work services. Furthermore councils are not undertaking these services in a competitive market. As RMS is paying **actual cost**, councils are not bearing the financial risks associated with undertaking these services. Consequently, there is no justification for Council to charge RMS an additional **ordered work margin** for estimating risk or rework or by way of a corporate contribution in the nature of a profit margin.

- Reconciliation of routine maintenance services will be at **actual cost**.
- Valuation of incident response services will be at **actual cost**.
- Valuation of ordered work will be for the agreed **Ordered Work Price**.
- **Actual cost** is defined as the sum of **direct cost** plus **indirect cost**.
- **Direct costs** means those costs directly expended in performing the particular services such as plant, material and labour (up to and including the level of work supervisor), any excess paid by the council in relation to a claim under the insurance referred to in clause 18.1, and third party claims made with respect to the services which would otherwise be covered by PAI, except the amount of the claim is less than the excess under PAI.
- **Indirect costs** means those costs indirectly expended in performing the particular services, such as site supervision, depot costs, management costs, insurance premiums (excluding premiums for contract works and public and products liability insurance).
- **Ordered Work Price** means the amount agreed between RMS and the council or determined or directed by RMS under Clause 7 as payable to the council for the carrying out of ordered work which may be payable on any of the following bases:
 - lump sum comprising of:
 - the Council's estimated **direct costs** and **indirect costs** of carrying out the ordered work;
 - the costs of preparing the estimate; and
 - the council's **ordered work margin**;

- **actual cost** of providing the ordered work, up to an amount set as the upper limit;
- **actual cost** of providing the ordered work without a set upper limit;
- schedule of rates; or
- any combination of the bases of payment set out in paragraphs (a), (b), (c) and (d) above.

Regardless of the basis of payment, council's proposed work price must separately identify the estimated **direct costs**, **indirect costs** and council's **ordered work margin**.

- **Ordered work margin** means an additional mark-up for estimating risk or risk of rework if the basis for payment is lump sum or schedule of rates.

Performance against these improvement plans and RMCC prerequisite requirements will be a condition of ongoing engagement of councils beyond July 2014.

These steps will contribute to improving road maintenance outcomes in regional areas utilising improved contract arrangements with Councils.

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Audit Findings

Most audited councils had elements of non-compliance with the RMCC requirements. Many need to improve their internal controls, general housekeeping and utilisation of systems. There are opportunities for councils to improve their administrative efficiency and communication between their accounts and engineering departments.

Key findings were:

- Non-compliance with guidelines for calculating **indirect costs**;
- Non-compliance with guidelines and failure to correctly distinguish **margin** for risk and profit;
- Establishment of "restricted accounts" to hold surplus revenues from RMCC rather than return to RMS;
- Setting different plant hire rates for internal and RMCC works, such differential being in the nature of a profit;
- Setting different overhead rates for internal and RMCC works without justifying the basis for such difference;
- System and internal control issues that affect transactional integrity;
- Lack of review and governance on transactional activity;
- Significant variation between councils in the applied percentage provision for overheads and margin without clear reason;
- Duplication of effort in recording accomplishment (REFLECT) and financial (GL) transactions;
- Reliance on junior, untrained staff to undertake transactional activity with inadequate verification and provisions for succession.

Next Steps

All councils are encouraged to review their internal policies, governance, systems and training with a view to ensuring the principles and conditions of the RMCC are upheld.

In 2013 RMS will conduct further audits on selected councils of financial performance and broader service provision under RMCCs.

Audit reports will be considered alongside improved Key Performance Measures assessment and Contractor Performance Reports to underpin Performance Improvement Plans that may be required under the contract.