

Oxford City Council

Barton Development Project

FINAL

Internal Audit Report
2012/2013
February 2013
27

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Distribution List

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Peter Sloman (Chief Executive)

Executive summary

Background

The Council is committed to investing in Oxford's future through the delivery of a range of physical regeneration projects to deliver new housing, create jobs and improve the quality of life in communities. This is in-line with the Council's ambition to create a world-class city for everyone, its corporate priority to build a vibrant and sustainable economy and the Oxfordshire Structure Plan 2016 which was adopted by the Council in 2005 and expects that 50% of all new housing in Oxfordshire should be affordable. The Barton development is an initiative to create a new neighbourhood and state-of-the-art community facilities to the west of Barton. The proposed site is between Barton and Northway and is intended to provide around 1,000 homes for Oxford residents.

The Council launched the selection process for a joint venture partner in November 2010 to help deliver the new neighbourhood at Barton. This has been set up as a LLP. Over 20 bids were received from a range of parties. On 23 September 2011, the Council entered into a joint venture with its preferred bidder Grosvenor Developments Limited (Grosvenor).

The Council has a 50% interest in the Company and shares profits and losses in accordance with a payment mechanism agreed between both parties. The Council received £0.5 million as a contribution to the costs of establishing the company in 2011/12 and transferred the land with a value of £0.8 million to the LLP on 31 October 2011. The land was subject to independent valuation and will be repaid with interest by January 2019.

At 31 March 2012 the company had net liabilities of £8,363. Fifty percent of these liabilities have been incorporated into the Council's Group Accounts. Net expenditure per the Group Comprehensive Income and Expenditure Statement is £228,844k.

The purpose of this review was to review the procurement process followed, contract terms and conditions and external advice received to determine whether the deal represents best value in light of the Council's corporate objectives.

Key findings

The procurement process was in line with the Council's procurement policy and the procurement process helped to secure value for money (VfM). The process adopted was in line with good practice: the Council adopted a business case development approach and followed a competitive tender process.

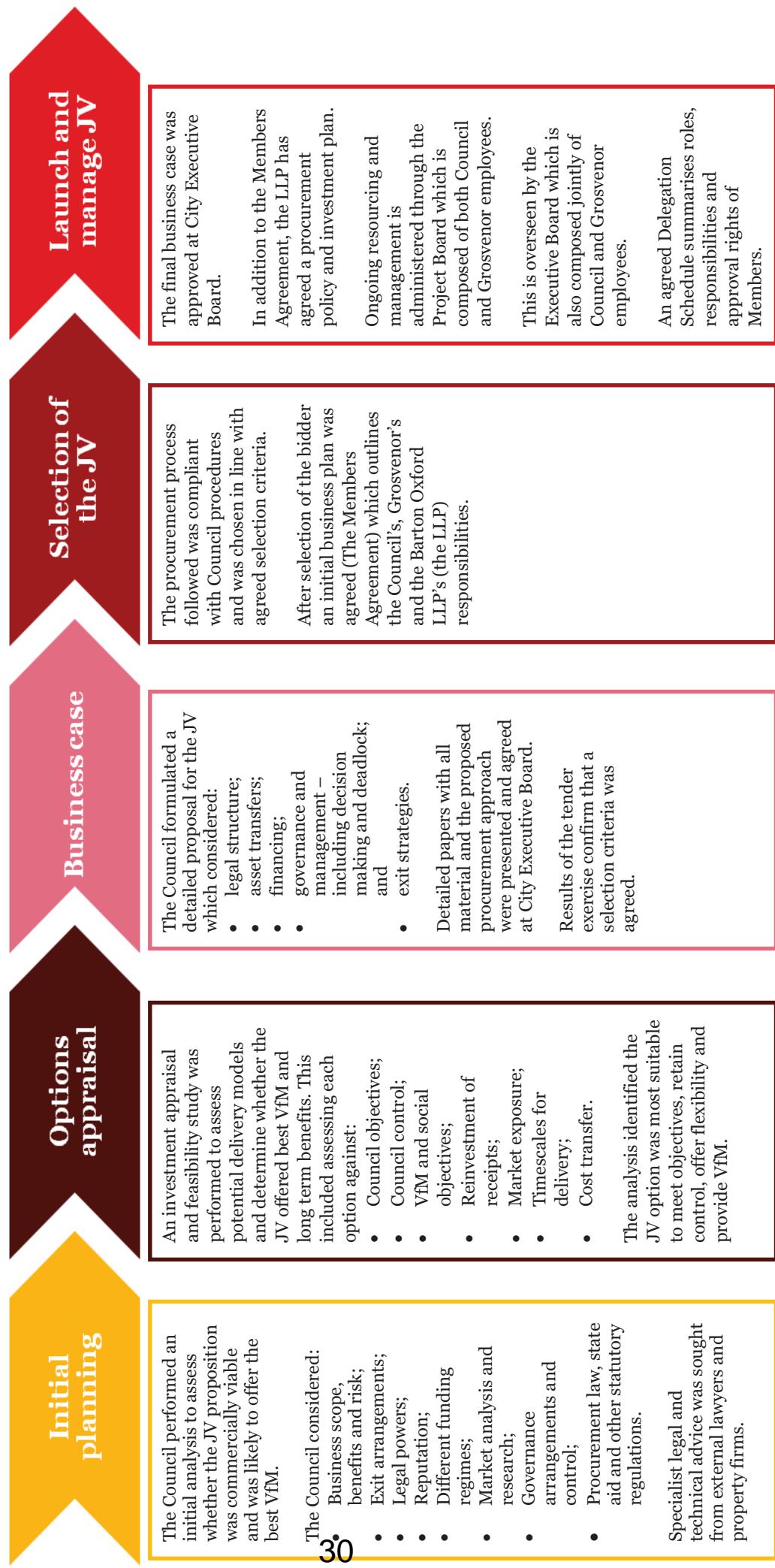
External advice received considered whole life costs, quality and user requirements to ensure VfM is achieved. This process involved performing an options appraisal which considered the benefits, drawbacks and risks of each option and assessment of both qualitative and quantitative factors.

The Members Agreement is also focused on VfM: it outlines the responsibilities of the joint venture (JV) between the Council and Grosvenor and contains aligned objectives, shared risks and rewards and a defined management and control framework. The JV provides VfM through combining the flexibility of a partnership with the safeguard of limited liability. This is supported by the payment mechanism which offers fiscal transparency and allows a flexible basis for profit distributions.

Our work also included an assessment of the process followed to arrive at the valuation of land transferred to the JV. Our work confirmed this was arrived at by an external valuer and based on the existing use value (EUV). The assessment of land included the consideration of whole life cost and value of the assets, timing and other sensitivities and included consideration of the ownership of the land and the social and economic development of the area – this is in line with good practice.

Procurement Process

Good practice suggests that joint ventures should be entered where there are complementary objectives and where there is a shared viewpoint on the nature and scope of activities and the joint venture's longer term objectives and benefits; this ought to be tested through business case development and a competitive tender procurement process. Our review shows the Council's procurement process is consistent with good practice - a summary of the approach against good practice is outlined below:

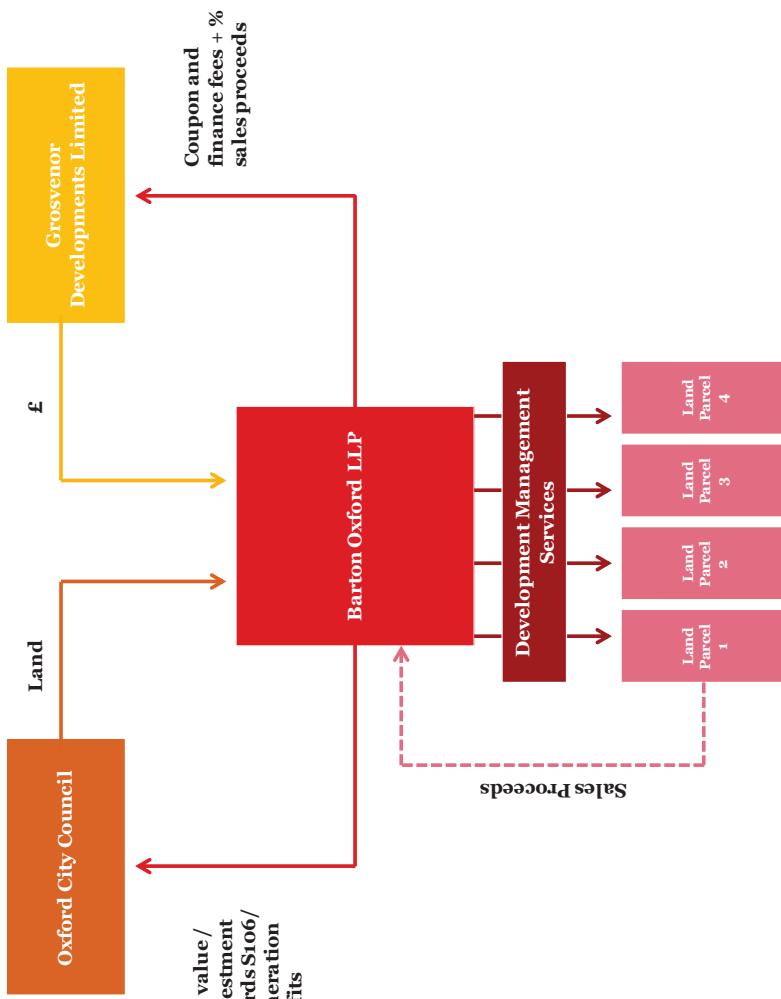


Contract Review

At the request of the Council, we have performed a high level review of the contract between the Council and Grosvenor in order to comment on its VfM. This included an assessment of the payment mechanism, an assessment of the transfer of risk to Grosvenor and the management of residual risk, a review of the Governance and reporting mechanism and a review of the external legal, financial and valuation advice received by the Council. Our findings are summarised below:

Payment Mechanism

The diagram below illustrates how the payment mechanism works¹:



¹ This has been taken from City Executive Board minutes, dated 10/11/2010, prepared by the Council

- Entering into an LLP gives fiscal transparency as each member is directly in receipt of its share of profits or losses of the LLP. It also allows a flexible basis for profit distributions. The following order of priority has been established for distribution of cash:
 - Repayment of Grosvenor funding contributions;
 - Repayment of Grosvenor returns;
 - Remaining balance up to a sum equal to 125% of the Transfer Price for land transferred by the Council to the LLP. This is divided 80:20 between the Council and Grosvenor; and
 - Remaining balances are distributed at a ratio of 60: 40 to the Council and Grosvenor respectively.
 - The arrangement is tax transparent. This means non-tax payers do not suffer value leakage;
 - The LLP arrangement combines the flexibility of a partnership with the safeguard of limited liability. As an LLP each member's liability is limited through the Limited Liability Partnership Act 2000, combining both the features of a UK Partnership and UK limited company.
- Transfer of risk and management of residual risk**
- The joint venture arrangement involves risk sharing. This offers the best structure for the Council whereby the management and mitigation of risk and realisation of benefits is shared between Members;
 - There is a common understanding and alignment of interests between the Council and Grosvenor of risks and their management. The LLP has its own objectives and there are agreed standards for assessing risk. These objectives are clearly aligned to the Council's own corporate objectives and strategy;
 - There is a joint risk register; this allows the Council and Grosvenor an opportunity to share judgements and enables a joint approach for managing risk. It also gives clarity on who is responsible for managing risk;
 - Risk communication, monitoring and managing of risk is inherent throughout the reporting process.
- Governance and reporting mechanism**
- A Project Board has been established to manage the day-to-day running of the project. This is combined of both Council and Grosvenor employees. An Executive Board has also been established to retain overall oversight of the LLP and monitoring overall strategic, operational and financial issues. These are deemed to be appropriate arrangements for monitoring the ongoing progress of the project, including risks and key issues;
 - The contract also includes a 'right of access' clause allowing each party to access information as defined in the contract.
- Legal, financial and valuation advice received**
- The Council has secured external legal and technical advice throughout the project to ensure VfM is achieved. This has included:
 - The appointment of external consultants by the Council and the Homes and Community Agency (HCA) to undertake a feasibility study for the Barton site's allocation for residential development. The consultancy team included:

- Knight Frank – who provided development appraisal and property advice;
- LDA Design – who advised on planning/master planning issues;
- Peter Brett Associates (PBA) – who provided engineering, technical and highway related advice; and
- Pinsent Masons – who provided some legal support.
- Independent advice (in addition to the joint arrangements with the HCA) was sought from Kings Sturge and Eversheds to provide technical and legal advice;
- An environmental report assessing the geo-physical, remediation strategy and cost aspects was performed by PBA;
- PBA – in conjunction with the County Council, as Highway Authority - also advised on highway and access solutions;
- Kings Sturge performed a viability study to examine different options;
- Both Kings Sturge and Eversheds provided advice in relation to the most appropriate vehicle through which to structure the JV and the resource/other implications for the Council in participating in this approach. This included a financial appraisal and tax implications.
- The Council has engaged Eversheds solicitors throughout the project. This has included providing advice on the legal position of the Council such as impact of the structure of the JV, procurement considerations and state aid considerations. The evaluation panel for the tender was chaired by senior representatives of Eversheds.

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Conclusion

The Council's approach is centred around achieving VfM. This is demonstrated through both external advice received and provisions of the contract (governance arrangements, the payment mechanism and risk transfer). External advice has considered the optimum combination of whole-life costs, quality and user requirements. This VfM assessment has followed a business case approach involving a staged process where different cases have been made for the proposed actions. These have been communicated and agreed at City Executive Board meetings.

VfM has been secured through the payment mechanism, risk transfer arrangements and governance mechanisms, for example:

- Complementary and aligned objectives;
- Shared risk and rewards;
- A defined and clear management and control framework;
- Performance of an options appraisal which compared the JV to other options including benefits, drawbacks and risks; and
- Assessment of qualitative factors – e.g. flexibility, management of risks, dispute resolution processes and deadlock, costs and roles and responsibilities borne by the Council – and quantitative factors, such as sensitivities.

Land valuation

Our third deliverable was to understand and, where appropriate and possible, validate the process followed to arrive at the assessment for the valuation of land transferred to the LJP. Our work in this area consisted of performing a review of the independent valuer's report against International Standards of Auditing (ISAs) used for assessing a management expert. This work has excluded performing an assessment of the appropriateness of the experts work. Key findings are below:

1. Competence, capability and objectivity of valuer

- The Council has used an external valuer to value their properties. The valuer was Kings Sturge who are an international property consultancy with operations across the UK and Europe. In May 2011, Kings Sturge were purchased by Jones Lang LaSalle.
- The valuation has been performed by a partner of the firm who was MRICS qualified.

2. Understanding of work performed

- The land value was arrived at by comparing it to similar sized lots. Adjustments were made for size, location, condition and existing use in forming views of EUV.
- This approach included consideration of the designations of the Oxford City Council Local Plan, Core Strategy and the emerging Barton Area Action Plan. This included consideration of the likelihood of land coming into further development as this would be considered by a purchaser in determining market value.
- It was noted that no planning applications has been approved as at the date of valuation but this would have increased the value of the land.
- Substation land was excluded and 'rate per acre' was applied for agricultural areas and the flood plain. Allotments and recreation areas were considered and included in EUV.

3. Role of external audit

ISA 500.8 states that if information used as audit evidence has been prepared using the work of a management's expert, the auditor must evaluate the competence, capabilities and objectivity of that expert, obtain an understanding of the work of that expert and evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. An unqualified opinion was issued over the financial statements for 2011/12. This included group accounts for the LLP.

4. Good practice

- Assessment of land has included elements of good practice, including:
 - The whole life cost and value of the assets has been understood;
 - Timing and other sensitivities were considered as part of the valuation e.g. the effect of not having planning applications and other recent sales;
 - Updates to City Executive Board demonstrate that ownership and title of land and the social and economic development of the area was considered.

Joint venture arrangement and risks

Our fourth deliverable was to identify any potential risks with the joint venture arrangement. The table below summarises the key risks identified and identified controls implemented by the Council to mitigate against these.

Risk	Controls
Lack of control	<ul style="list-style-type: none">Delivering services through partners can bring significant benefits and help bring about successful innovation but the arrangement offers less direct control than delivering them alone. The Council has managed this through developing a Project Board and Executive Board which include representatives from both the Council and Grosvenor.Rights of access have been included in the Members Agreement giving transparency to both parties.
Separate lines of accountability	<ul style="list-style-type: none">The development of the Project Board and Executive Board for the LLP means both parties are accountable to the same governance and reporting mechanism.
Failure to align agendas and ineffective communication mechanisms could create polarised perspectives and difficulties in agreeing roles and responsibilities	<ul style="list-style-type: none">The Council has adopted good practice established for contractual relationships for use with other partners. For example they have agreed separate objectives, owned by the LLP.Objectives are aligned to the Council's corporate priorities and are revisited at Project Board and Executive Board meetings to monitor progress.The Members Agreement defines the roles and responsibilities of:<ul style="list-style-type: none">the LLP, Council and Grosvenor;Project Board and Executive Board; andindividual roles.
Service delivery chains can be complex this may mean that defining responsibilities for managing risk may be a challenge	<ul style="list-style-type: none">The diversity of different cultures in partnerships brings a need to understand different perspectives on risks and arrangements for managing them. The Barton Oxford LLP has its own risk register which is reported to Project Board and Executive Board. This provides opportunity to share judgements and gives complete understanding to both parties enabling a joint approach for managing risks.The responsibilities of relevant parties are outlined in the Members Agreement giving clarity on who is responsible for the management of risk.
Controls could undermine the joint venture's ability to be effective in delivering the objectives for which it was established	<ul style="list-style-type: none">The development of a specific project team, who report to Project Board and Executive Board mitigates against this risk; objectives and progress against these is reported as part of the reporting protocols in place.

Appendix 1. Terms of Reference

Oxford City Council Terms of Reference – Barton Development Project

To: Jackie Yates, Executive Director – Organisational Development and Corporate Services
From: Charlotte Bilsland, Audit Manager

This review is being undertaken as part of the 2012/13 internal audit plan approved by the Audit Committee.

Background

Oxford City Council ('the Council') is committed to investing in Oxford's future through the delivery of a range of physical regeneration projects to deliver new housing, create jobs and improve the quality of life in communities. This is in-line with the Council's ambition to create a world-class city for everyone, its corporate priority to build a vibrant and sustainable economy and the Oxfordshire Structure Plan 2016 which was adopted by the Council in 2005 and expects that 50% of all new housing in Oxfordshire should be affordable.

The Barton development is an initiative to create a new neighbourhood and state-of-the-art community facilities to the west of Barton. The proposed site is between Barton and Northway and is intended to provide around 1,000 homes for Oxford residents.

The Council launched the selection process for a joint venture partner in November 2010 to help deliver the new neighbourhood at Barton. Over 20 bids were received from a mix of parties. On 23 September 2011, the Council entered into a joint venture with its preferred bidder, Grosvenor Developments Limited ('Grosvenor').

The Council has a 50% interest in the Company and shares profits and losses in accordance with a payment mechanism agreed between both parties. The Council received £0.5 million as a contribution to the costs of establishing the company in 2011/12 and transferred the land with a value of £0.8 million to the LLP on 31 October 2011. The land was subject to independent valuation and will be repaid with interest by January 2019.

As at 31 March 2012 the company had net liabilities of £8,363. 50% of these have been incorporated into the Council's Group Accounts. Net expenditure per the Group Comprehensive Income and Expenditure Statement is £228,844k.

Scope

This review will cover the following scope:

- A review of the Council's procurement process followed and compliance checks to ensure this was in line with Council procedures and recognised best practice;
- A high level review of the contract between the Council and Grosvenor in order to comment on its value for money. This will include:
 - An assessment of the payment mechanism;
 - An assessment of the transfer of risk to Grosvenor and the management of residual risk;
 - A review of the Governance and reporting mechanism; and
 - A review of the external legal, financial and valuation advice received by the Council.
- We will understand and, where appropriate and possible, validate the process followed to arrive at the assessment for the valuation of land transferred to the LLP;
- We will understand the structure of the joint venture arrangement and identify any potential risks with the structure.

Limitations of scope

The scope of our work will be limited to those areas outlined above. This review is deemed as value enhancing within the Internal Audit plan. No consideration will be made of control design and operating effectiveness.

Our review will be performed in the context of the information provided to us. Where circumstances change the review outputs may no longer be applicable. In these situations, we accept no responsibility in respect of the advice given. Our deliverables are limited to those outlined within the scope above.

Our review of the contract is limited to a high level review of the contract. We will support our understanding of the areas of contract management outlined in the scope above, through interviews and discussions with relevant personnel and our knowledge and experience of contract management practices we have seen elsewhere. In making this assessment we may corroborate certain practices, however we will not be substantively validating or testing all of the information provided.

The scope of work includes a review of the external legal, financial and valuation advice received by the Council. Our work in this area will be limited to reviewing the different advice received and validating any data where appropriate and possible to do so. We will not perform any assessment of the quality of advice received or provide any advice of this nature.

Our review of the land valuation will constitute understanding and where appropriate, validating the process followed to arrive at the valuation of land. This will not involve any judgement or challenge of the land value agreed or recalculation of land value.

The services and deliverables are designed to assist you in considering the ongoing management of the Barton development however it is your decision whether or not to proceed with this execution.

The services do not include the provision of due diligence services and are not intended to form the basis of an investment decision by you.

Review approach

Our audit approach is as follows:

- Obtain an understanding of the Barton Development Project through discussions with key personnel, review of the contract and procurement documentation and other reports;
- Identify any risks relating to the project and overall governance structure;
- Corroborate key practices.

Internal audit team

Name	Role
Richard Bacon	Engagement Leader
Chris Dickens	Chief Internal Auditor
Charlotte Bilساند	Audit Manager

Key contacts

Name	Title	Role	Responsibilities
Jackie Yates	Executive Director – Organisational Development and Corporate Services	Audit Sponsor*	Review and approve terms of reference
David Edwards	Executive Director – Regeneration and Housing	Audit Contact	Review draft report
Steve Sprason	Head of Corporate Assets	Audit Contact	Review final report
Jane Winfield	Major Projects and Disposals Manager	Audit Contact	Hold initial scoping meeting Review and meet to discuss issues arising and develop management responses and action plan

Other Roles and Responsibilities

Name	Title	Responsibilities
Nigel Kennedy	Head of Finance	Receive agreed terms of reference Receive draft and final reports
Peter Sloman	Chief Executive	Receive final report

* The audit sponsor should respond by email to the audit manager to confirm agreement with these Terms of Reference. By agreeing to the document, the responsible manager is confirming the following:

- Appropriateness of scope and any limitation;
- All relevant documentation, including source data, reports and procedures, will be made available to us promptly on request;
- Staff and management will make reasonable time available for interviews and will respond promptly to follow-up questions or requests for documentation; and
- Agreement with the timetable of reporting within the document and the audit reporting protocol within the Annual Audit plan.

Timetable

Fieldwork start	w/c 08/10/2012
Fieldwork completed	31/10/2012
Clearance Meeting	w/c 05/11/2012
Draft report to client	w/c 05/11/2012
Response from client	w/c 12/11/2012
Final report to client	w/c 19/11/2012

Agreed timescales are subject to the following assumptions:

- All relevant documentation, including source data, reports and procedures, will be made available to us promptly on request; and
- Staff and management will make reasonable time available for interviews and will respond promptly to follow-up questions or requests for documentation.

Appendix 2. Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken the review of the Barton Development Project is subject to the limitations outlined below.

Internal control

Internal control, no matter how well designed and operated, can provide only reasonable and not absolute assurance regarding achievement of an organisation's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

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Future periods

Our assessment of controls relating to the Barton Project is for the 2012/13 year.

Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

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