

Bath & North East Somerset Council

Bath Spa Project – Position statement as
at 31 January 2006

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Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

We perform our audit in accordance with the Audit Commission's Code of Audit Practice (the Code), which was issued in March 2002. This is supported by the Statement of Responsibilities of Auditors and Audited Bodies, which was issued in April 2000. Both documents are available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end, and what is to be expected of the audited body in certain areas. Our reports and audit letters are prepared in the context of this statement and in accordance with the Code.

Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body, and no responsibility is taken by auditors to any Member or officer in their individual capacity, or to any third party. A new Code of Audit Practice will be in place for the 2005/06 audit year, together with a new Statement of Responsibilities of Auditors and Audited Bodies, both of which were issued in March 2005

The matters raised in this and other reports that flow from our review are only those which have come to our attention arising from or relevant to our work that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks in the Council or all internal control weaknesses. This report has been prepared solely for the use of Bath & North East Somerset Council and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.

1 Introduction

- 1 The springs in Bath are unique and the Roman Baths are a major tourist attraction. In 1978 the thermal baths were closed and since then the public have not had access to the natural thermal waters. During the 1980s and early 1990s you considered a number of commercial schemes to re-establish a Spa. In 1996 you agreed to develop a project which included the development of a new Spa building.
- 2 You made a preliminary application to the Millennium Commission in September 1996, estimating a total capital cost of £12.2m, with a request for a 50% contribution. The indicative project timetable showed construction starting in June 1998 to complete in December 1999.
- 3 You produced a Detailed Appraisal Review (DAR) in July 1997 based on an outline conceptual design showing a total capital cost of £13.558m. The DAR also highlighted that your contribution to the Project would amount to £3.160m consisting of a cash contribution of £2m and the transfer of land and property valued at £1.160m.
- 4 Right from the start, the Project has been dogged with significant engineering and design problems, repeatedly delaying the completion, which, at the time of writing was forecast for April 2006. Additionally, the Council, its professional advisers and contractors have been frequently unable to agree responsibility for the problems, leading to continuous advice from lawyers and other advisors. Several senior people involved with the Project including the Corporate Director have left the Council.
- 5 The latest projected total cost of the Spa (excluding interest and future claims) is £44.570m. The cost to the Council after taking into account external funding for the Project of £13.896m is £30.674m. These amounts include contract variations which are currently under review, but exclude any claims which you may have to accept in full or part and the claims you may make against others. In addition the forecast excludes the future costs of handling claims.

Audit Approach

- 6 When we met with the Chief Executive and Director of Resources in November 2004, we had major concerns over the ongoing disputes between the Project Manager (GTMS), the Designers, (Grimshaws) and the Main Contractor, (Mowlems) and that the Project was effectively at a standstill. It was therefore agreed that we would undertake a review of the Project as part of our external audit and in particular we would consider the plans to complete the Project and to consider the financial implications on the Council.
- 7 We emphasised that a comprehensive audit review of the Spa Project would need to be undertaken when the Project was complete and the overall financial position was settled, and that the findings could form part of a public interest report.
- 8 Against this background our audit approach during 2005 has been to meet regularly with the Council's Project Adviser and other officers to review developments and to focus on the overall financial position. We will continue to monitor developments during 2006 and in particular the Claims position. A draft copy of this report was made available to senior officers and some members of the Executive in January and February 2006.

Acknowledgements

- 9 We would like to thank senior managers for the help and cooperation provided to us during the course of our review.

2 Executive Summary

Background

- 10 The initial proposals submitted to the Millennium Commission in 1997 identified an estimated gross cost of £13.558m and required the Council to contribute £3.160m to the Project in the form of property valued at £1.160m and cash of £2m. Since then costs have increased significantly.

Projected Outturn – project cost – excluding claims	£m
September 1996 – Initial stage 1 application subsequently reported to Economic Development Committee and Policy and Resources Committee in October and December 1996 respectively.	12.200
February 1997 – Policy and Resources Committee	12.540
July 1997 – Stage 2 DAR application	13.558
July 2000 – Council meeting	19.095
January 2001 – Council meeting	22.644
September 2003 – Executive and Resources O&S £26.043m (inc £3m claims)	23.043
March 2004 - Council	26.139
October 2004 - Council	32.000
January 2005 – Council – (£35.521 inc £600k claims)	34.921
January 2006 – Council Executive	36.198

- 11 The latest projected total cost (excluding interest and claims) is £44.570m. The cost to the Council after taking into account external funding for the Project of £13.896m is £30.674m. This includes the value of the property transferred and contract variations which are currently under review, but excludes any claims which you may have to accept in full or part and the claims you may make against others. In addition the forecast excludes interest and the future costs of handling claims.

Main developments during 2005

- 12 The Project progressed significantly during 2005. However in January 2005 the project was at a virtual standstill and relationships between the Main Contractor, the Designers and the Project Managers were particularly strained. Over £150,000 per month was being spent and there appeared to be little prospect of the Project being completed in the foreseeable future. At this time, you appointed a Major Projects Director, re-established the Bath Spa Project Board and developed an overall strategy to complete the Project.
- 13 Following the receipt of legal Counsel's advice you decided to treat the main contract as being at an end. Mowlems vacated the site in April 2005. This enabled you to take direct control and plan for completion. The detailed condition surveys undertaken in April and May 2005 identified some defects in the construction. However, a large number of additional defects have been identified since.
- 14 In April 2005, £27.095m of the £35.521m budget agreed at the January 2005 Council meeting had been spent, leaving £7.826m including a contingency of £1.5m for unseen costs. The rectification works and their associated costs incurred in the latter half of 2005 have been much greater than anticipated and the project contingency of £1.5m was fully absorbed. In January 2006 the Executive announced the need to increase the budget for the Project by a further £1.277m.

- 15 The estimated project outturn increased regularly since May 2005 because of significant additional rectification work and the associated programme slippage. In November 2005 the Project Board saw the projected outturn increase by £0.537m and again by £0.819m in December 2005. Some of these additional costs reflect new technologies and materials but the majority reflect the rectification work needed to address the defects which were not apparent in April 2005.
- 16 In the light of the additional rectification works uncovered, it has proved difficult to provide the monthly Project Board with accurate forecasts of projected costs. However, it is essential that a detailed review of the costs to completion is undertaken to accurately identify the outturn for the Project. Sensitivity analysis should be performed to produce a full range of potential costs.

Future risks

- 17 In July 2005 you announced that the Spa would be opened in April 2006 following completion in December 2005. However, the considerable number of additional defects experienced since July 2005 has resulted in the practical completion date slipping by 4 months to April 2006. The critical path for completion in April 2006 is very much dependent on no further defects arising. Given the problems encountered to date, the level of work that still needs to be completed and the significant levels of risk remaining within the programme, the current plans to complete the Spa in April 2006 will be challenging.
- 18 Further delays will lead to further adverse publicity and result in additional costs. It will be important that the Project Board assess the probability of being able to complete in April 2006 as a matter of priority and if appropriate consider deferring this date. Any announcement will need to be made in consultation with your public relations advisers. Budgets will also need to be revisited to take into account the additional costs which amount to approximately £133,000 per month in consultancy fees alone.

Financial standing

- 19 The Council bears the rising cost of the project but the Millennium Commission's contribution has remained constant, other than an increase of £1m agreed in 1999. An application to the Millennium Commission in 2005 for additional funding was rejected. Without Millennium Commission support you will have to cover all the additional costs, although some of these may be recovered by claims against other parties. Ignoring the net impact of claims (which may be positive or negative), the net cost of the Project (excluding interest) is £30.674m compared with the £3.160m originally envisaged. The Project has utilised a significant proportion of your available capital resources.
- 20 You have a significant asset base relative to many other councils. You are actively pursuing ways in which you can make best use of your capital assets and generate further capital receipts to offset the impact of these rising costs.

Claims

- 21 Significant claims are likely to be made by and against the Council. In November 2004 it was estimated that the overall outcome on claims could prove favourable to the total project cost at one extreme or adverse at the other, with a potential range of approximately £10m in either direction. As a result, significant sums have been invested in your preparations to handle claims. At the time of writing (January 2006) the Project Board was awaiting receipt of a report from legal advisers that will assess the scale and likelihood of success of claims. It is anticipated that this report will be a key factor in determining the future approach to handling claims.

- 22 We have discussed with officers our view that accounting standards do not allow all of your claims handling expenditure, in total £1.7m in 2005/06, to be capitalised as part of the Spa Project. You have applied three times to ODPM for a dispensation to allow all of the costs to be capitalised to avoid a direct impact on the revenue budget, but this has not been forthcoming. The costs in 2005/06 will be charged to the revenue account. You will need to continue to plan carefully for claims management costs.

Conclusion

- 23 The Project has been subject to an exceptional level of defects and rectification works that have led to significant delays, cost overruns and deterioration in relationships between the Main Contractor (Mowlem), Designer (Grimshaw) and Project Manager (GTMS). In January 2005, the project was at a virtual impasse with costs accumulating at a concerning rate.
- 24 The deadlock was broken in April 2005 when you decided to treat the main contract as being at an end, the main contractor left the site and you took direct control for completion of the Project. A considerable amount of rectification work needed to be undertaken and, additionally, further defects were discovered during this period. Although you plan to reclaim the cost of these works, you have had to initially fund the completion with no certainty of recovery.
- 25 The Project has utilised a significant proportion of your available capital resources and will have an impact on your revenue budgets. However, you have a significant asset base and are actively pursuing ways to make best use of this to generate further capital receipts.
- 26 Claims costs remain a major risk for the future. Additionally, the cost of claims management will impact on your revenue budgets.

3 Main developments during 2005

27 In this Section we outline some of the main developments during the course of 2005.

January 2005 – April 2005

28 During this period relationships with the Main Contractor continued to be particularly poor and the Project was at a virtual standstill. There were a number of major issues with the construction works including:

- **Leaks** - water leaks had been identified in the Steam Room Floor and the pool surrounds. Instructions were issued to the Main contractor to remove the Steam Room floor for inspection in December 2004. This was followed by further instructions in January 2005 to remove the other floor surrounds for inspection. Reports from independent consultants identified poor workmanship as being the main cause of the leaks.
- **Scum channels** - additional works were also required on the waterproofing of the pool scum channels. Water stain marks due to leakage had become visible on the inside surfaces of the roof top pool in particular.
- **Pool paint defects** - the sub contractors were in the process of addressing the significant pool paint defects that had been identified in 2004.

29 In January 2005 Council approved a further budget increase for the project of £3.5m. This represented a contingency for the costs of the 5 month extension of the project due to the defective floor work – estimated to cost £3m. In addition a budget of £300,000 was created in respect of boreholes and water supply works and £200,000 for the electronic document management system.

Main contractor offer

30 During late December 2004 and January 2005 “without prejudice” discussions were held with the Main Contractor with a view to them addressing the workmanship issues and completing the project for a fixed sum. Discussions were on-going for 6 weeks but no details of the fixed sum were provided.

31 The Main Contractor took the step of releasing a press statement on 4 February 2005 without first consulting you. The press statement made an offer to complete the Spa works (if full control was passed to them) within 6 months for not more than £26m.

32 It appeared that the offer included the restatement of all pool floor surrounds, the commissioning of equipment, the completion of the Operator fit-out works and resolution of all defects and snags to the building, but you did not receive sufficient detail to appraise this option fully.

33 Following specialist legal advice and consideration of the offer you rejected it, because:

- **Value for Money** – the offer did not appear to offer value for money and appeared to include a significant premium, the level of which depends on the main contractor’s valuation or the quantity surveyor’s valuations.
- **Quality of workmanship** – the quality of the floors and other issues identified raised concerns over whether the contractor would undertake the remaining works to an acceptable quality.

- **Onsite review** - the offer was subject to the Project Managers (GTMS) at that time not being on-site. There were concerns that there would not be an on-site independent Architect/Design Team to provide assurance over the quality of workmanship; and
 - **Risk sharing** – there was very little information concerning risk sharing in the offer.
- 34 The problems and defects that have been identified since April 2005 provide additional support for the decision taken to reject the offer.

Other matters during period

- 35 During this period there were a number of issues including the following:
- **Water supply** – various issues were identified in relation to the water supply to the Spa during this period. These issues were subsequently resolved and technical experts are now confident that there is sufficient clear water to meet the needs of the Spa.
 - **Advisers** – the contract administration arrangements were reviewed and expressions of interest were sought for a contract administrator/project manager. Following competitive tender Capita Symonds were appointed to replace GTMS in March 2005, and new legal advisers were appointed.
 - **Public relations** – there were significant levels of adverse public relations coverage in the local and national media. This included adverse comments made by an MP (who was a Minister at the time acting in his personal capacity) when visiting the site.
 - **Major Projects Directorate** – a major Projects Director was appointed and he took responsibility for the Spa from January 2005.

April – August 2005

- 36 The main building contract was reviewed. The new legal advisors suggested that action could be taken in view of the ongoing difficulties. Subsequent to this you decided to treat the main contract as being at an end and the site was formally handed over to you in April 2005.
- 37 During April 2005 Capita Symonds arranged for a detailed condition survey of the site and a video diary was maintained by the Clerk of Works. The former Main Contractor was invited to participate in the condition survey and the results were shared with them, and GTMS prepared a report in May 2005. This was subsequently costed by Capita Symonds and Gardiner & Theobald who produced the initial cost estimate to complete the project. This differentiated between the construction and non-construction costs.
- 38 A decision was taken not to appoint a new main contractor. Capita Symonds were appointed as the Construction Project manager and tasked with organising the procurement process. During July 2005 you were required to go out to tender for a number of contractors as the “New Project” developed, some of the existing contractors were kept where performance was satisfactory. Your lawyers provided advice on procurement matters.

Commencement of construction of New Project

39 The main areas of work focussed on the following areas:

- **Defective flooring** - work to removing defective screed in the roof top pool, the lower ground pool and the steam room. The architects initially instructed the contractors to reinstate two floors but only to overlay the steam room floor, but later instructed that the screed be completely relaid.
- **Water proofing** - it was agreed to use a different product to that originally specified. Your architects issued an instruction to reinstate the floors with the new product on 10 June 2005 - the rooftop pool, the steam room pool and part of the lower ground pool. One week later they noticed a number of further defects on the lower ground pool and decided that all of the lower ground pool should be reinstated.
- **Further defects** – when the screed was removed further defects were found. Fittings on the steam room doors also needed replacing for example. In view of the claims position you have taken measures to carefully log the extra defects and cost them.
- **Glazing** – Specialists undertook a survey in July 2005 and concluded that the glazing was delaminated because of the way the glass had been fixed to the frame. This was disputed by the contractors. There was some concern over the long lead times for the glass.
- **Pool Plant** - regulations concerning bathing water had moved on significantly since the Spa was initially designed. In July 2005 you were informed that the ozone treatment plant may not be the best option. You were therefore considering the procurement of an alternative UV water treatment system which you subsequently opted for.

Other matters

- **Relationships with TDC** – TDC have been understandably concerned at the delays.
- **Project leader** - following the creation of the Major Projects Directorate and the Council taking over direct control of the project, you recognised the need to appoint a Project leader with commercial experience to lead on the Spa. The Project Leader started in May 2005.
- **Project reporting** - a Project Board comprising senior officers and members was re-established during this period. A comprehensive and detailed reporting and risk management system was also introduced.

August 2005 – December 2005

40 During this period further progress was made but a large number of additional defects were found which were not immediately apparent when the condition surveys were undertaken in May and June 2005. Many defects were only found when floors were removed. Major difficulties have been experienced with mechanical and electrical work, and further problems specialist painting to the walls and ceilings of the lower ground floor pools has been required.

Conclusion

- 41 Limited progress was made on the Spa in early 2005. In January 2005 the project was at a virtual standstill and relationships the Main Contractor (Mowlems), the Designers (Grimshaw) and the Project Managers (GTMS) were particularly strained. Costs were accumulating at a concerning rate and there appeared to be little prospect of the Project being completed in the foreseeable future. The appointment of the Major Projects Director, the reestablishment of the Bath Spa Project Board together with changes in some of the main advisers resulted in the development of an overall strategy to complete the Project.
- 42 Following Counsel's advice you decided to treat the main contract as being at an end and the Main Contractor left the site in April 2005. This enabled you to take control of the Project and put measures in place for its completion. The detailed condition surveys undertaken in April and May 2005 identified some defects in the construction. However, a large number of additional defects have been identified since which has led to further delays in the completion of the project. Whilst good progress has been made in the second half of 2005 there nevertheless still remains much to be done before practical completion is reached.

4 Potential risks in the completion of the project

Background

- 43 Following the condition survey in May 2005 it was anticipated that the construction would be completed by Christmas 2005, with plant and equipment commissioned thereafter. This would provide sufficient time for the “fit out” to be completed. You then announced the completion would be April 2006. It was acknowledged that this time scale represented a reasonably aggressive programme but there was some contingency within it to deal with unforeseen problems with construction and commissioning. The programme recognised that the plant had been lying idle since July 2003 and therefore it was likely it would need to go through a whole commissioning process.
- 44 In early August 2005 Capita Symonds reported on some delays in producing detailed drawings by the design team to resolve outstanding issues. You were finding it difficult to agree contractual terms with several contractors who you were informed were still owed sums by the former Main Contractor at that time.
- 45 In early August 2005 it was considered that the Project was six weeks behind schedule but there was sufficient contingency in the programme for it not to impact on the opening date.
- 46 In subsequent months the practical completion date was extended to February 2006 and has recently been extended to April 2006. The Project has already slipped 4 months as a result of the identification of the substantial defects identified following the original condition survey undertaken in April/May 2005. There is still a significant amount of work to be done. The finance report presented to the Project Board on 29 November identified that only £3m out of the £5.250m, that had been profiled to be spent by mid October 2005, had been incurred.

Future risks

- 47 Further defects and problems could yet be found. There are a significant number of risks that have an impact on the completion of the project such risks include:
- **Glazing** – the 29 November Project Board approved the complete replacement of glazing, at a cost of around £700,000. This work will be undertaken in mid February to March 2006. Long lead in-times on ordering the glass has an impact for the completion of this work. Adverse weather conditions during this period could have a major impact on ability to meet this deadline.
 - **Roof top pool** – this is an open pool but with a temporary cover. Significant construction work is yet to be undertaken including applying screed and waterproofing, fixing tiles and filling pool with thermal water. The completion of this work requires reasonably warm and dry conditions. Adverse weather conditions could have major impact on the ability to complete these within timescales.
 - **Commissioning of mechanical and electrical equipment** – significant problems have been identified to date with the mechanical and electrical installations. A major exercise is scheduled to be undertaken to commission air conditioning and electrical systems. The practical completion depends on no further major problems being identified.

- **Disabled lifts** – the disabled lifts have shown signs of corrosion and need to be replaced. An acceptable solution is in the process of being identified and costed.
- **Decoration** – as a result of peeling paint (above the water level) significant areas of the lower ground pool need to be repainted. The cost is significant and requires removal of previous paint and application of new paint.
- **Lower ground floor pool** – problems with “above ground paintwork” has led to significant delays in the completion of the construction work in this area. This now represents the critical path on the project and it is still necessary to strip the existing paint and repaint surfaces, remove scaffolding, complete application of the floor screed, apply waterproofing and apply tiles.
- **Fill pools with thermal water** – the pools have yet to be filled with thermal water. Technical reports have emphasised that new waterproofing solution should not lead to peeling paint problems that were previously experienced.
- **Running “fit out” in parallel** – it was originally anticipated that “fitting out” would take place after the completion of the construction phase. In view of the delay in the project this will now be undertaken in parallel and could therefore result in problems arising from integration.
- **Volume of work** – the volume of work that needs to be undertaken by April is significant and is dependent on sufficient manpower being available to complete the work.
- **TDC** – finalising the lease and water supply agreements with TDC.
- **Practical completion certificate** – the practical completion certificate will need to be issued once Capita Symonds, NGP and Ove Arup are satisfied with the work including the work undertaken by the previous contractor. This could take longer than anticipated given the significant difficulties encountered with the Project.

Conclusion

- 48 You have publicly announced that the Spa will be completed in April 2006. This announcement was made during July 2005 when practical completion was estimated to be December 2005. However the considerable difficulties experienced in the last six months have resulted in the Practical Completion date slipping by four months to April 2006. The critical path for completion in April 2006 is very much dependent on no further difficulties arising. Given the problems encountered to date, the level of work that still needs to be completed and the level of inherent risk within the programme, the current plans to finish the Spa in April 2006 are challenging.
- 49 Failure to complete in April 2006 will inevitably lead to further adverse publicity and result in additional costs. It will be important that you assess the probability of being able to complete in April 2006 as a matter of priority and if appropriate consider deferring the date. Any announcement will need to be made in consultation with your public relation advisors and take into account the additional costs which amount to approximately £133,000 per month.

5 Impact of Increased Project Costs on Financial Standing

Background

- 50 The initial proposals prepared in 1996 identified a projected gross cost of £12.200m and required the Council to contribute £3.160 to the Project in the form of property valued at £1.160m and cash of £2m. Since then costs have increased significantly. The projected outturn costs of the Project since 1996 can be summarised as follows:

Projected Outturn – project cost – excluding claims	£m
September 1996 – Initial stage 1 application subsequently reported to Economic Development Committee and Policy and Resources Committee in October and December 1996 respectively.	12.200
February 1997 – Policy and Resources Committee	12.540
July 1997 – Stage 2 DAR application	13.558
July 2000 – Council meeting	19.095
January 2001 – Council meeting	22.644
September 2003 – Executive and Resources O&S £26.043m (inc £3m claims)	23.043
March 2004 - Council	26.139
October 2004 - Council	32.000
January 2005 – Council –(£35,521 inc £600k claims)	34.921
January 2006 – Council Executive	35.578

- 51 Taking into account the costs of claims and payments on account the total estimated project cost can be summarised as follows:

Project Costs	£m
Estimated Expenditure	
“Old” Project (excluding property valuation)	26.911
“New” project	9.903
Claims Project	
Claims Management costs for 2005/06 Only)	3.533
Payments on Account (Liability being reviewed)	2.638
Total Expenditure	43.495
Property at Valuation (excluding purchase of 7 Bath St)	1.075
Total Estimated Project Cost	44.570

Costs of new project

- 52 You decided to treat the main contract as being at an end in April 2005. It was agreed that the pre 14 April 2005 costs of would be allocated to the “Old Project” These costs would then be frozen and future costs would be charged to the “New Project”.
- 53 In May 2005 you anticipated that the remaining unspent budget of £7.826m would be adequate to complete the Project and provide a contingency of £1.5m for unforeseen

costs. In addition it was agreed that a budget of £600,000 would be set up for the Claims project. The total combined budget for the 3 projects was £35.521million (i.e. the amount that had been approved by Council in January 2005).

Use of contingency

- 54 The costing schedule prepared by Capita Symonds and Gardiner & Theobald was presented to the 29 November 2005 Project Board. It indicated that the projected outturn for the new project was still £7.826million but that only £130,000 of the original £1.5 million contingency remained. At the 20 December 2005 meeting of the Spa Board, the costing schedule showed that the contingency had been used and a budget overspend of £819,000 was being forecast. In January 2006 the Executive advised that the budget for the Project should be increased by £1.273m
- 55 In summary, the forecast cost of the New Project (ignoring contingencies) at the end of 2005 was £2.3million higher than anticipated in May 2005. Gardiner Theobald produced a report to the December Spa Project Board setting out the reasons for the additional costs. The main variations can be summarised as follows:

Area	£000
Various unspecified items	211
Screed, waterproof preparation	353
Mechanical and electrical	248
Water works rectification	195
UV Treatment	91
Glazing defects	424
Painting	194
Consultants fees – 4 months delay	602
Other	322
Total	2,640

- 56 One of the most significant areas is in respect of consultants' fees for delays in the programme which amount to approximately £133,000 for each month of delay.
- 57 The forecast outturn (as at 31 January 2006) is £0.777m higher than the revised budget set in January 2005 and it is recognised that a further amounts will be required to complete the construction of the Project.

Impact on financial resources

- 58 To date you have dealt with the escalating costs of the Spa as they have arisen. The Council was debt free and you have been able to incorporate increases in cost into the

capital budget. The Project has utilised a significant proportion of the Council's available capital resources and will have an impact on your revenue budgets.

- 59 A paper to Council Executive in November 2005 ('Capital Programme Review' – The Implications of Major Projects') considers the financial impact of all major projects. This report recognises the reduction in the Authority's available capital receipts and identifies that the Council may require unsupported borrowing of up to £65m over the next 4 years to finance the complete capital programme (including the Spa) in the absence of additional capital receipts. This is a worst case scenario and we are aware that you are in the process of securing additional receipts. The additional costs of the Spa have had a direct impact on this level of potential unsupported borrowing.
- 60 You have a significant asset base relative to many other councils. You are actively pursuing ways in which you can make best use of your capital assets and generate further capital receipts. You also recognise the need to consider the affordability and the phasing of the current capital programme in light of available resources.

Millennium Commission

- 61 Representatives from the Millennium Commission visited the site in July 2005 and indicated that they may be prepared to provide additional funding. This was subject to you providing them with additional costing details and analyses. At that time it was hoped that the Millennium Commission would provide as much as £4-5 million of additional funding. After significant efforts to produce detailed costings and analyses for the Millennium Commission your application for additional funding was rejected in October 2005.

Conclusion

- 62 The initial proposals submitted to the Millennium Commission in 1997 identified a projected gross cost of £12.540m and required the Council to contribute £3.160 to the Project in the form of property valued at £1.160m and cash of £2m. Since then costs have increased significantly and the total projected estimated cost amounts to £44.570m which after taking into account Millennium Commission funding and the TDC contribution amounts to a net cost to the Council of £30.674m. The net cost does not however include the impact of claims, future claim handling costs which are likely to be significant and the interest forgone on the funds.
- 63 The additional costs will impact on the availability of your capital resources and revenue budgets.

6 Claims

- 64 You identified in November 2004 that the range in value between the potential claims against the Council and the potential claims that could be made by the Council could amount to approximately £20m. At this time you had been notified of claims from the former Main Contractor totalling £7.396m. However no further claims have been received since the Contractor left the site in April 2005. A separate Claims Management Board had been set up in the Council and a Claims Management Group had been set up to consider claims received and to be made.
- 65 The potential costs of researching, defending and settling claims were not fully reflected in the forecast cost proposals considered by the Council in January 2005 and a budget provision of £250,000 was included in the forecast. At that time it was estimated that the cost of employing a 'Claims Settlement Team' would amount to approximately £3.15m in the years 2004/05 to 2006/07. However this amount was only based on an initial assessment of the costs.
- 66 During 2005/06 specialist claims lawyers were appointed to undertake an in-depth review of the Council's position. This decision together with the preparations made to organise the supporting records and documentation has resulted in a significant acceleration in the levels of expenditure being incurred on claims management. It is anticipated that an interim claims strategy report will be completed in early 2006 and further work will need to be undertaken in the remainder of the current financial year.
- 67 The anticipated costs of the in depth review were reported to the Executive in Autumn 2005 and it is likely that the anticipated claims management costs will amount to £1.7m in 2005/06 and a further £351k was approved in March 2006. Further costs are anticipated in 2006/07. The extent of these costs will be dependent on the levels of claims activity which cannot be estimated with any degree of certainty.
- 68 The decision taken to treat the main contract as being at an end and to appoint new professional advisers coupled with the significant problems encountered on the Project suggests that there is a potential for further claims. This decision and the identification of the subsequent significant defects will mean that you will need to maintain meticulous records to defend or take forward any claim. In recognition of this you have embarked on a major exercise to scan all the documentation and detailed condition surveys and diaries have been maintained since taking over the site. The claims management process is likely to result in significant costs arising and you will need to consider the cost benefits of defending and/or pursuing claims under review. You will also need to consider the potential to negotiate a settlement at an early stage and in the event that it results in value for money.

Claims handling costs – accounting treatment

- 69 There is currently uncertainty as to whether you will be able to capitalise the costs associated with the claims handling strategy. The initial view is that this expenditure should not be capitalised in accordance with Financial Reporting Standard 15 – Tangible Fixed Assets, and should be charged to the revenue account. You are currently producing further analyses of the expenditure and we are reviewing the accounting treatment. You have already made three unsuccessful approaches to the ODPM. The costs in 2005/06 will be charged to the revenue account. You will need to continue to plan carefully for claims management costs.

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