FINAL INTERNAL AUDIT REPORT

Management of NEC3 Compensation Events (IA 12 521)

Andrew Wolstenholme, Chief Executive

Audit Conclusion: Adequately Controlled and Audit Closed

02 December 2013

<table>
<thead>
<tr>
<th>Number of issues</th>
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<tr>
<td>Priority 1</td>
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<td>Priority 2</td>
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<td>Priority 3</td>
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EXECUTIVE SUMMARY

Introduction and background

The term ‘compensation event’ refers to a situation where either the scope of the contract or other event requires the contractor to undertake additional work that he was not originally contracted to provide. As a result, the contractor incurs costs and/or time not originally forecast through the implementation of a Project Manager’s Instruction (PMI).

There are nineteen defined events that constitute a Compensation Event in NEC3. In addition CRL has defined an additional Compensation Event under the Z clauses for its NEC3 contracts.

An Early Warning Notice (EWN) is the process by which the Contractor or the Project Manager notify each other of any matter that may impact upon the cost or schedule of the contract. By the end of Period 3 of the current financial year there had been 13,406 (EWNs) raised and 12,367 EWNs closed. Similarly, 10,063 Notifications of Compensation Events (NCEs) had been received with a total value of £957.3M and 931 NCEs had been rejected or withdrawn with a total value of £22.7M.

Claims that are accepted are recorded as Implemented Compensation Events (ICE) and by the end of Period 3 of the current financial year there had been 7,432 of these with total value of £636.4M. Out of these 1,673 were implemented under a Project Manager’s Assessment (PMA) with a total value of £181.5M.

In order to ensure projects are delivered successfully, the management of Compensation Events is critical as failure to manage them effectively may lead to unnecessary increases in costs and/or overrun to the delivery of the project.

Objective

This audit provides assurance regarding the effectiveness of Crossrail’s management of NEC3 Compensation Events.

Scope

The audit focused on the control environment in relation to the following key risk areas:

- Management of risks associated with the compensation events including adequacy of documentation and adequate skilled resources.
- Policy and procedures on how compensation events are to be managed.
Management of NEC3 Compensation Events (IA 12 521)

- Roles and responsibilities relevant to the management of compensation events.
- Compliance with relevant contractual terms and conditions.
- Change control process including assessment of impact upon scope, cost and schedule.
- Document management systems and process for correspondence relating to compensation events.
- Systems and processes used to track and monitor the status of compensation events and forecasting of the future impact of compensation events on project scope, scheduled timing and final cost.

Summary of findings

All the scope areas were examined during the audit.

We found the following examples of good practice:

- The Contract Administration Manual (CAM) provides staff with clear and consistent guidance for the effective management of NEC3 compensation events. It is easy to follow and readily available to relevant staff. Although the CAM does not cover all forms of NEC3, it does provide a solid basis for the effective administration of NEC3 contracts within Crossrail. The CAM is also explicit in stating that it is there to support the effective administration of contracts but does not supersede them. A similar manual could be beneficial if adapted and applied across the whole of TfL.

- Use of eB Contract Admin (eB CA) as a single document control system which supports an audit trail for each part of the compensation event process and the effective management of contracts. Training and support are provided to staff and contractors on system use. There is also a process for staff to provide feedback and suggestions for improving how the system works, which results in changes being implemented.

The review identified only one Priority 3 issue (see Appendix 2 for definitions of priority ratings), which is set out in the Detailed Findings section of the report. A summary of the findings under each scope area is set out in the following paragraphs.

Management of Risk

Risks are managed primarily through the use of a document control system that enables the early capture, assessment and monitoring of mitigating action for each risk or EWN as they are recorded. Possible actions include closing the EWN, identifying additional information required, mitigation action that would reduce or remove the risk, or accepting the EWN as a compensation event.
Policy and Procedures
The CAM contains policy and procedures for staff to follow to minimise the potential for adverse claims from not following due process. No evidence was found of inconsistencies in how the CAM is applied. Staff can provide feedback directly to the Contract Administration team if updates to the manual are required.

Roles, Responsibilities and Compliance with contractual terms
All staff interviewed demonstrated good knowledge of the NEC3 framework, the purpose of the contract, their own role and responsibilities and where to go for support or advice. Ensuring compliance with contractual terms requires use of eB and availability of appropriate resources for staff when support is needed.

The use of eB CA supports adherence to the contract and its associated processes for effective contract management.

Change Control
Change is managed as part of the compensation event process where any impact on cost or schedule is assessed and actioned accordingly. Any changes are reported to management via the Area Director’s Periodic Report including numbers and values for EWNs raised and closed in the period, NCEs raised, closed and implemented in the period and values for ICEs.

Document Management and Control
Documents are managed and controlled through the use of eB. The system enables communications to be channelled via the appropriate approval route before they are released. The contract specifies that only communications received via this channel will be deemed to be “official” otherwise they have no standing contractually. We noted instances where the contractors did not always link documents in the correct manner. This is raised as a priority 3 issue below.

Tracking and Monitoring
Progress on each project is tracked and monitored through the use of eB and all data can be exported into project specific reports and registers using Excel spreadsheets. Each compensation event or potential compensation event, with actions and review dates is recorded on eB along with relevant information like projected costs and review dates. Excel reports are used to simplify the tracking and monitoring process by condensing information from eB onto a single spreadsheet.

Reporting and Forecasting
Information is provided on a regular basis to senior management via the project Dashboard Reports and the Area Director’s Period Report which also help to
focus attention on the tracking, monitoring and forecasting of compensation events. Information from eB is also used to populate the Commercial Balance Sheet which has been introduced recently as a means to provide even more detailed management information for forecasting the impact of compensation events.

Conclusion

On the basis of the work completed, we have concluded that the Management of NEC3 Compensation Events is adequately controlled.

Follow up

We are satisfied that continued use of existing controls will be a sufficient to address the priority 3 issue identified. Accordingly we do not intend to conduct a follow up review. This audit is now closed.

We would like to thank all those who were involved in and contributed to this audit.
DETAILED FINDINGS – PRIORITY 3 ISSUES

1. Contractors do not always link documents in the correct manner

Issue

Each stage of the Compensation Event process requires information to be recorded on eB. When an event is recorded supporting documentation should be uploaded if not already held on eB and these documents should be linked directly to the event. Some contractors do not always link the documents in the correct manner because they do not understand or have not had sufficient training on eB. Instead of linking the document they will link another stage for the same event. For example, when recording a NCE instead of linking the relevant documents directly to the event they will link the EWN record instead.

Risk exposure

Incorrectly linked documents means that the project team have to expend time and resources in rectifying the problem to ensure that claims are correctly assessed and processed.

Management action plan

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<tr>
<th>Agreed action</th>
<th>Manager responsible</th>
<th>Due date</th>
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<tr>
<td>Continue to ensure that Contractors use eB where required in relation to the management and evidencing of Compensation Events</td>
<td>Sean Gray</td>
<td>Implemented as at 20 November 2013</td>
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APPENDIX 1 – Distribution list

This report was sent to Andrew Wolstenholme, Chief Executive, by Clive Walker, Director of Internal Audit, and copied to:

- David Morrice Head of Contracts
- Sean Gray Head of Contract Administration
- Martin Buck Commercial Director
- Steve Elliot Programme Controls Director
- John Russell Management Systems & Assurance
- David Allen Finance Director
- Andy Mitchell Programme Director
- Rob Halstead Head of Risk Management
- Robert Flanagan Finance Operations Director
- Nigel Blore Head of Group Insurance, TfL
- Andrea Clarke Director of Legal, TfL
- David Goldstone Chief Finance Officer, TfL
- Steve Allen MD, Finance, TfL
- Howard Carter General Counsel, TfL
- Robert Brent KPMG
APPENDIX 2 – Definition of issue ratings

Priority 1

Significant weakness(es) in the control environment which, if not addressed, have the potential to undermine the achievement of key corporate and/or business area objectives. These weaknesses require urgent management attention.

Priority 2

Other control weakness(es) that are less significant but still have the potential to threaten the achievement of corporate and/or business area objectives. These weaknesses require management attention.

Priority 3

While not necessarily a control weakness there is potential for process improvement by, for example, ensuring compliance with good practice, increasing process efficiency, identifying areas of ‘over control’, or strengthening the overall control environment by building upon the existing controls.