



**Special Report of the  
Auditor General  
on the  
Motor Vehicle Safety and Emissions  
Testing Programme**

**October 2010**



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The Honourable Stanley Lowe, JP, MP  
Speaker of the House of Assembly  
Bermuda

Sir:

Pursuant to Section 13 of the Audit Act 1990, I have the honour to submit herewith my Special Report on the Motor Vehicle Safety and Emissions Testing Programme.

Respectfully submitted

A handwritten signature in black ink, appearing to read 'HJM', followed by a horizontal line extending to the right.

Heather A. Jacobs Matthews, JP, CA, CFE  
Auditor General

Hamilton, Bermuda  
October 2010



# INTRODUCTION



*The new TCD Administration Building*

## ***Report Purpose***

During the course of the audit of the 2009 Consolidated Fund, I found serious internal control deficiencies in the management and oversight of various capital development projects. One of the projects in question was the development of the Motor Vehicle Safety and Emissions Testing Programme which had an initial budget of \$5.3 million and a final cost of \$15.23 million. A subsequent audit of the project, which culminated in this special report, confirmed that the project lacked the necessary oversight and project management processes to ensure value for money.

*Audit Mandate, Reporting Authority, Policies and Practices* The Bermuda Constitution Order 1968 and the Audit Act 1990 provide the legislative mandate for the Office of the Auditor General. Our audit work is conducted in accordance with our legislative mandate and our policies and practices. These policies and practices embrace the standards recommended by the Institute of Chartered Accountants of Bermuda and Canada.

Sections 12 and 13 of the Audit Act 1990 (the Act) authorize the Auditor General to present special reports to the Speaker of the House of Assembly, the Governor and the President of the Senate. Where a matter is of significant public interest, the Auditor General is required to make an immediate report in accordance with the legislation. The Act allows me considerable discretion to decide the form and content of my reports to the House of Assembly.

*Audit Committee* The draft report was also reviewed by the Government's Audit Committee established under section 5 of the Act. The Committee's role includes reviewing and discussing with me drafts of my public reports, and communicating to Cabinet any matters the Committee believes should be brought to Cabinet's attention.

The members of the Audit Committee are:

<b>Name</b>	<b>Position</b>	<b>Employer</b>
Mr. Thomas E.C. Miller, FCA, Chairman	Partner	PricewaterhouseCoopers Chartered Accountants
Mrs. Pamela Greyson, CGA, Deputy Chair	Treasurer	Bermuda Conference of Seventh-day Adventists
Mr. Kirk Davis, CA	President & CEO	Pin High Limited
Mr. Larry Mussenden, LL.B.	Partner	Mussenden Subair Barristers & Attorneys
Mr. Ronald E. Simmons, JP, CA	Partner	Moore, Stephens & Butterfield Chartered Accountants
Mr. Ottiwell Simmons, JP		
The Honourable Paula Cox, JP, MP (ex-officio member)	Minister of Finance	

***Acknowledgements*** I wish to thank the members of the Committee for their valued input. I also wish to acknowledge the co-operation and assistance extended to my staff during the course of the audit. Finally, I wish to acknowledge the hard work, professionalism and dedication of my staff during the conduct of the audit and the subsequent production of this report.

## AUDITOR GENERAL'S COMMENTS

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*The Public has a right to know*

Government is responsible for safeguarding public monies and the public has a right to know that public monies are adequately protected and managed.

*Financial Instructions are in place*

To address this, Government has in place formal rules and regulations called Financial Instructions which are mandated by the Public Treasury (Administration and Payments) Act 1969 and which provide the minimum standard for financial controls in every Ministry and Department. Financial Instructions direct civil servants in their handling of financial transactions to ensure that public monies are properly safeguarded.

*W&E held to a greater degree of accountability*

The Ministry of Works and Engineering (W&E) has a greater degree of accountability, given its responsibility for managing major capital projects. Financial Instructions recognize the nature of W&E's operations, and the need for W&E to adopt more rigorous and complex procedures. These extended procurement procedures must be adhered to for all major capital development projects.

*Consultant firm hired to oversee the project*

Unfortunately, this was not the case in the development of the Motor Vehicle Safety and Emissions Testing Programme, which included the construction of a new Transport Control Department (TCD) Administration Building with testing facilities in Hamilton, and two satellite testing facilities - one in St. George's and the other in Southampton.

Responsibility for the successful completion of the project was vested in TCD (a department within the Ministry of Transport) instead of W&E. TCD then contracted with the consultant firm, Bermuda Emissions Control Ltd. (BECL) to manage the project, thereby reducing the level of scrutiny that may otherwise have been conducted had the project been managed or overseen by W&E.

***Ministerial interference***

Furthermore, the audit revealed Ministerial interference at the outset. Such interference undermined Government's control environment and firmly established the direction taken by senior Civil Servants to move this project forward. In 2001, two years before Cabinet approved a proposal to contract BECL, the Minister of Transport confirmed in writing to BECL (copied to the Director of TCD), Government's decision "*to waive the requirement to advertise for tendering and award any contract for services dealing with vehicle emissions testing to Bermuda Emission Control Ltd*".

***Consultant hires related company***

BECL subsequently entered into lump sum contracts with Correia Construction Company Limited (CCCL) to build three facilities, none of which were tendered. It should be noted that CCCL was related by common ownership to BECL.

***Consultant becomes the operator***

During the construction phase, BECL was also awarded the contract to operate the three facilities for an annual fee of \$2.4 million.

***Initial budget of \$5.3 million; final cost to the taxpayer was \$15.23 million***

The Motor Vehicle Safety and Emissions Testing Programme had an initial capital expenditure budget of \$5.3 million in 2004/05 which increased to \$8.6 million in 2007/08 and then to \$14.25 million in 2008/09. In the end, the project cost taxpayers \$15.23 million. In addition, the contract to operate the three facilities has the potential to cost Government in the region of \$24 million over a ten-year period.

***Internal control deficiencies led to a qualified audit report***

This capital development project was one of three that caused me to qualify the financial statements of the Consolidated Fund for the year ended March 31, 2009 due to serious internal control deficiencies in the management of the projects. I decided that my Office should take a closer look at the Motor Vehicle Safety and Emissions Testing Programme to determine if it was managed by Government to provide value for money.

*No assurance that value for money was achieved*

This report sets out the results of my audit of the management of the Motor Vehicle Safety and Emissions Testing Programme. I concluded that the processes used by Government to oversee the Project did not provide assurance that value for money was achieved.

*Government relinquished control but retained financial risk*

I further concluded that the manner in which the project was managed resulted in Government retaining all the financial risks while effectively relinquishing control over the development costs to a consultant company (BECL) that became the operator of the Emissions Testing Facilities and a construction company (CCCL) that was related to the consultant company.

*Situation is disturbing*

This situation is quite disturbing. As discussed previously, Government has established Financial Instructions designed to help it manage large projects effectively through W&E. However, when these are circumvented, ignored or not used on a consistent basis then the result is that Government is not managing the public resources with which it has been entrusted with appropriate due care.

*W&E has a mandate to carry out Capital Development Projects*

It is important to note that the Government's 2010/11 Budget Book, states that W&E's mission is "*To Deliver the Government's Capital Development Programme in a Professional, Fiscally Prudent and Timely Manner*". When a project has been transferred to another ministry, it is expected that they will fully comply with Financial Instructions.

***Management of public funds is a major responsibility***

In conclusion, I am hopeful that this report will serve to remind Government Ministers and senior Civil Servants that the management of public funds is a major responsibility and one that is not to be taken lightly. It is therefore incumbent on senior Civil Servants to ensure that mandated policies and procedures are complied with at all levels within the Service. This is necessary to achieve economy, efficiency, effectiveness and transparency - and in so doing, enhance the public's trust and confidence in Government's management of public finances.

***Penalties for non-compliance***

Civil Servants are also reminded that Financial Instructions make provision for surcharge and penalties where there is non-compliance with Financial Instructions.

***Guidance for Ministers and Civil Servants***

Ministers and Civil Servants should also familiarize themselves with the Ministerial Code of Conduct issued in April 2002. The Code advises Ministers of their "*duty to uphold the impartiality of the Civil Service*" and to refrain from asking Civil Servants to act in a way which would compromise their "*personal responsibility for the propriety and regularity of the public finances*" for which they are responsible. Section 12.3 of the Ministerial Code of Conduct provides detailed steps that should be taken by Accounting Officers if a Minister is contemplating a course of action which involves a transaction that "*would breach the requirements of propriety and regularity*".



Heather A. Jacobs Matthews, JP, CA, CFE  
Auditor General

### **Audit Purpose and Scope**

The overall purpose of our audit was to determine if the development of the Motor Vehicle Safety and Emissions Testing Programme was properly managed by Government to provide value for money to the taxpayer.

To do this, we assessed the appropriateness of the processes used by Government to:

- Select the contractors
- Review and approve the contracts
- Review and approve changes to the contracts
- Monitor the contracts

Our audit focused on the work of Government Ministries and Departments. It was not an audit of the private companies involved in the project. Neither did we assess the need, nature or scope of the project or the decision to outsource the construction and operation of the testing facilities.

We completed our audit in September 2010. Our work covered the period 1997 to 2010 and included discussions with and documentation provided by BECL and senior Civil Servants from the Ministries of Tourism and Transport, Finance and W&E.

## Summary of Findings

Our findings included the following:

- **Ministerial directive that compromised Civil Servants' ability to comply with Financial Instructions;**
- **Non-compliance with Government's tendering policies and payment procedures;**
- **Contract signed-off for construction of new TCD building before acquiring a complete set of drawings;**
- **An inherent conflict of interest between BECL, the consultant, and CCCL, the contractor, as both were 30% owned by the same individual;**
- **Cabinet approval not obtained prior to the signing of any of the contracts relating to either construction or operation of the testing facilities;**
- **Cabinet's request that the construction of the satellite facilities should follow the open tender process was disregarded by civil servants;**
- **Insufficient documentation to support increases in the Capital Budget from \$8.6 million to \$14.25 million; and**
- **No vetting of the operating agreement or of the projected annual operating expenses which formed the basis for the annual fee paid to BECL.**

## **Audit Conclusion**

We concluded that the processes used by Government to oversee the development of the Motor Vehicle Safety and Emissions Testing Programme did not provide assurance that value for money was achieved.

By not following its established procedures for the management of capital development projects, Government retained the financial risks of developing the Motor Vehicle Safety and Emissions Testing Programme whilst effectively relinquishing control over the development costs to a consultant company (that was to become the operator of the programme) and a construction company (that had common ownership with the consultant company).

# MANAGEMENT OF THE PROJECT

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## Background

The Motor Vehicle Safety and Emissions Testing Programme was contemplated since the latter part of the 1990s and received Cabinet approval to proceed in June 2003. The project development was managed by TCD, a department of the Ministry of Transport.

The manner in which the project was implemented had some unusual features. The following chronology of key events is intended to provide some context for our audit findings and conclusions.

## Chronology of Key Events

**September 1997:** BECL is formed by two entrepreneurs, D. Smith and J. M. Madeiros.

**October 1997:** A report by de la Torre Klausmeier Consulting, “An Assessment of Emission Control Strategies for Motor Vehicles in Bermuda”, which was commissioned jointly by the then Ministry of Transport and Civil Aviation and the Ministry of Environment, recommends that the Government:

- adopt U.S. or European emission standards for motor vehicles sold in Bermuda;
- adopt an inspection/maintenance program for light and heavy duty vehicles;
- adopt regulations that would require all motor vehicles to be periodically inspected to ensure compliance with adopted emission standards; and
- hire a contractor to train technicians, perform inspections on light-duty vehicles and licence garages to inspect diesel powered vehicles.

**July 2000:** Cabinet agrees to:

- import motor vehicles that meet certain international emission standards;
- have BECL establish an emission standard for Bermuda by testing a representative sample of 600 to 900 vehicles; and
- issue instructions to the Attorney-General to make changes to the *Motor Car Act 1951* so that all imported gasoline and diesel fuelled motor vehicles are required to comply with various international emission standards.

**August 2001:** The *Motor Car Amendment (No 2) Act 2001* and the *Auxiliary Bicycles Amendment (No 2) Act 2001* receive assent.

**August 2001:** The Minister of Transport notifies BECL, in writing, of Government's decision to waive the tendering requirement and award any related contracts to BECL. The Minister also reveals that an emissions testing programme has yet to be established by the Ministry and therefore states, "...specific details as to what services may be required of your Company are not yet available."

**December 2001:** According to the Explanatory Notes which appeared in the Capital Account Estimates in the Approved Estimates of Revenue and Expenditure for 2002/03, accounting responsibility for capital development projects relating to the Ministry of Transport is delegated to the Ministry of Transport. However, and with a few other exceptions, "accounting responsibility for all capital development expenditures rests with the Permanent Secretary of the Ministry of Works and Engineering".

**February 2003:** A 30% shareholder of CCCL, D. Correia, becomes a 30% shareholder of BECL.

**June 2003:** The Minister of Transport advises Cabinet that BECL was previously determined to be the *preferred contractor*. Cabinet then:

- approves a proposal to contract BECL to provide an emissions inspection maintenance programme and to outsource the vehicle safety inspection service;
- authorizes TCD to contract with a private sector consultant for project management services;
- approves a proposal to revise vehicle license and inspection fees with effect from April 1, 2004; and
- authorizes the Minister of Transport to issue instructions to the Attorney-General's Chambers to draft the legislation necessary to implement the above programmes.

Cabinet documents indicate that BECL had initially proposed that:

- it would fund, with CCCL, the initial design and construction of a new vehicle testing and administration facility;
- it would construct two smaller testing facilities, at the eastern (St. George's) and western (Southampton) ends of the Island;
- the Government would purchase the buildings, furnishings and equipment from BECL on April 1, 2004 for \$5.3 million (i.e. a build-then-buy arrangement);
- BECL would conduct annual emissions testing and vehicle safety inspections for approximately \$1.77 million annually; and
- the testing contract with BECL would be for a five-year period with an option for a five-year extension.

**July 2003:** The Ministry of Transport's Permanent Secretary submits a Capital Project Proposal to the Ministry of Finance with respect to the emissions and testing project showing a total capital cost of \$5.3 million.

**December 2004:** The Minister of Tourism and Transport, in accordance with section 53A(2)(a) of the Motor Car Act 1951 and section 17A(2)(a) of the Auxiliary Bicycles Act 1954, approves the Motor Car (Emissions Standards) Order 2004 and the Auxiliary Bicycles (Emissions and Standards) Order 2004. These legislative amendments enabled the Government to implement an emissions testing programme that requires vehicles to comply with approved emissions standards before a license is granted.

**February 2005:** Concerns are raised within Government that the build-then-buy arrangement is not the most cost-effective way to proceed, since the building construction would not be tendered.

**February 2005:** In an e-mail to a number of officials from various government ministries, including the Ministry of Tourism and Transport, the Accountant-General indicates that there does not exist a case to “contravene” Financial Instructions with respect to the construction of the satellite facilities, as the buildings are of simple construction and several contractors could do the work. The Accountant-General then specifies various issues that would need to be addressed in order to make the case to not follow the Government’s tendering requirements. The Ministry of Tourism and Transport’s Permanent Secretary then instructs the Director of TCD to have BECL prepare a brief that responds to the conditions set forth by the Accountant-General “*succinctly and speedily*”.

**May 2005:** Cabinet approves the construction of the two satellite facilities subject to “*an open tender process*”. BECL is engaged to prepare all of the tender documents. Cabinet also decided to have BECL supply and install all of the emissions testing equipment.

**May 2005:** Cabinet agrees to lease land from the Bermuda Land Development Company for its satellite testing sites and thereafter sublease the land to BECL once the testing program commences.

**March 2006:** BECL writes to the Accountant-General and acknowledges the common ownership of BECL and CCCL. BECL goes on to state that they see this common ownership as a “*distinct advantage*” for the project.

**April 2006:** The Accountant-General indicates that BECL is in compliance with Financial Instructions, as BECL obtained three “*quotes*” on the cost of the satellite facilities.

**October 2006:** The Ministry of Tourism and Transport submits a revised Capital Project Proposal that increases the Programme’s capital budget to \$8.6 million.

**December 2006:** A consultancy agreement between the Government and BECL is signed. The agreement makes BECL responsible for the construction of the two satellite facilities. The agreement also requires BECL to “*adhere to all rules, regulations and policies which are or may hereinafter be established by the Government.*”

**December 2006:** BECL enters into an untendered \$571,000 lump sum construction contract with CCCL for the construction of the Southampton satellite facility.

**December 2006:** BECL enters into an untendered \$586,000 lump sum construction contract with CCCL for the construction of the St. George’s satellite facility.

**March 2007:** BECL enters into a \$1.3 million contract with Systech International for the supply and installation of the testing equipment at all three facilities.

**May 2007:** BECL enters into an untendered \$8.95 million lump sum contract with CCCL to build the main testing facility.

**September 2007:** The Ministry of Tourism and Transport increases the capital budget from \$8.6 million to \$12.9 million. According to the Ministry of Tourism and Transport, the increase relates to additional costs pertaining to the main facility that were not included in the previous capital budget. (The Ministry of Finance eventually increased the Project's total budget to \$14.25 million.)

**January 2008:** The Ministry of Tourism and Transport approves the first change order relating to the construction of the main facility. The change order amounted to \$114,000 and relates to additional footage of pilings (i.e. foundation support) and an increase in the number of piles.

**April 2008:** The Ministry of Tourism and Transport approves the second change order relating to the construction of the main facility. The change costs \$1.054 million and relates to extra costs not originally allowed for in previous estimates and additional requirements added by TCD.

**July 2008:** The Ministry of Tourism and Transport approves the third change order relating to the construction of the main facility. The change costs \$304,000 and relates to additional electrical work.

**November 2008:** The Ministry of Tourism and Transport approves the fourth change order relating to the construction of the main facility. The change costs \$125,000 and relates to the supply and installation of additional material for stair risers.

**December 2008:** Cabinet approves the operating agreement with BECL. As part of its approval, Cabinet sanctions an increase in the annual fee payable to BECL from \$1.77 million to \$2.4 million.

**March 2009:** The Ministry of Tourism and Transport approves the fifth change order relating to the construction of the main facility. The change costs \$17,000 and is for miscellaneous items.

**April 2009:** BECL commences safety and emissions inspections at the three testing facilities.

## **Detailed Audit Findings**

### **Selecting the Contractors**

There were a number of significant decision points during the development of the Motor Vehicle Safety and Emissions Testing Programme, including the selection of the contractor who would build the main facility and the two satellite facilities and the contractor who would operate the testing facilities.

The regulations concerning the management of capital development projects are set out in “Financial Instructions”.

These instructions derive from the Public Treasury (Administration and Payments) Act, 1969, in which Section 3(1) requires that *“Every person concerned in or responsible for . . . the payment of public monies . . . shall obey all instructions that may from time to time be issued by the Minister... in respect of the custody and handling of the same and accounting therefor”*.

The Government’s procurement guidelines (P.F.A. 2002) for this capital development project required that it follow an *“Open Tender”* process, whereby the Government, by press advertisement, invites contractors to bid on the construction project.

A competitive tender process for major contracts assists in ensuring that Government construction contracts provide value for money (and allows Government to demonstrate that such is the case). These instructions should have been complied with for the Motor Vehicle Safety and Emissions Testing Programme.

### ***The Building Contractors***

The project had four significant capital expenditure components:

- The main facility
- The satellite testing facility in St. George's
- The satellite testing facility in Southampton
- The specialist testing equipment

Financial Instructions state that *“the accounting responsibility for capital development rests with the Permanent Secretary for the Ministry of Works and Engineering, who is the Accounting Officer for all projects in the Capital Development Estimates, with the exception of minor works.”* However, starting with the 2002-03 fiscal year, the Approved Estimates of Revenue & Expenditure (Schedule C-1) state that *“...projects of the Ministry of Transport are also outside the scope of responsibility of the Permanent Secretary of W&E. . .”*

The rationale for this exclusion is not clear, particularly as W&E has the capacity (systems, processes and qualified personnel) required to manage capital projects and the Ministry of Transport does not.

The only reason provided to us by the Financial Secretary for this anomaly was that:

*“The Department of Airport Operations (DAO) developed a capacity for capital project management in order to ensure that the Government of Bermuda could meet specific requirements and regulations related to airport standards promulgated by the International Civil Aviation Organization (ICAO). The capital project management function was incorporated into the post of Manager of Maintenance & Engineering sometime in 2000/01. With the development of project management capability within DAO it was logical to vest control of development and management of airport infrastructure with the Permanent Secretary of Transport.”*

To the best of our knowledge, however, the Motor Vehicle Safety and Emissions Testing Programme was the sole responsibility of TCD, a totally separate division of the Ministry of Transport and no individuals from the DAO were involved.

As discussed later in this report, assigning responsibility for this capital development project to the Ministry of Transport significantly diminished Government's capacity to manage the project effectively. For example, had P.F.A. 2002 been applied during the procurement phase, a higher level of scrutiny would have been employed.

In 2003 Cabinet gave its approval to proceed with the project and to contract with BECL to oversee its development. Supporting documents indicate that the buildings were to be funded by BECL, built by a sole sourced contractor, CCCL, and then subsequently purchased by Government (i.e. a build-then-buy arrangement).

It should be noted that at the time of this original approval by Cabinet, the stated cost of the three buildings, equipment and furnishings was \$5.3 million (compared to the eventual total cost of \$15.23 million).

According to correspondence in 2005 between W&E and the Accountant-General, it was decided that the build-then-buy arrangement was not the most cost-effective way to proceed. It was felt that because the construction of the buildings was not tendered, it would not be known whether a fair price was obtained.

Subsequently, the Ministry of Tourism and Transport proposed that since BECL was to supply and install all equipment, BECL and CCCL should together carry out all the building construction. This proposal was made in full knowledge that a principal shareholder and director of CCCL was also a principal shareholder of BECL, thus creating a potential conflict of interest.

This proposal was referred to the Accountant-General, who suggested that a detailed business case needed to be made to support the sole-sourcing of the satellite facilities construction contracts. On March 8, 2006 BECL submitted a letter to the Accountant-General explaining the reasons why they believed CCCL should be chosen to construct the satellite facilities. As part of their analysis, BECL compared CCCL's construction cost estimates to two cost estimates prepared by two independent construction consulting firms.

In an April 10, 2006 e-mail to the Ministry of Tourism and Transport's Controller, the Accountant-General concluded that BECL was in compliance with Financial Instructions because BECL obtained three quotes - one from CCCL and the other two from the two construction consulting firms. However, our audit reveals that the consulting firms did not bid on the satellite construction contracts. Instead, both firms were engaged by BECL to assess the reasonableness of the construction rates used by CCCL. In our view, these two assessments cannot therefore be considered legitimate bids for the purposes of Financial Instructions, which require a full and open tender process.

Although the Accountant-General went on to state that "*Typically experts in the field will review the estimates to ensure the three quotes are comparing 'apples and apples'*", the Accountant-General failed to recognize the need to follow an open tender process. It is important to note that the inability of the Accountant-General to bring this project back in-line with Financial Instructions can somewhat be explained by the pressure exerted on the Accountant-General to "*just make it happen.*"

The desire to openly tender the satellite facilities building construction contracts was confirmed in part by Cabinet's approval in May 2005 to move ahead with the construction of the two satellite sites, following an "*open tender process*". I question why the Permanent Secretary in the Ministry of Tourism and Transport ignored the direction of Cabinet. Furthermore, we were not provided with any evidence that Cabinet specifically approved the go ahead of the construction of the main facility.

Despite the above issues, and without following an open tender process as directed by Cabinet, BECL entered into lump sum contracts in December 2006 and May 2007 with CCCL to build the main facility and two satellite facilities.

## **The Operating Contractor**

The selection of a contractor to operate the Safety and Emissions Testing Programme had significant financial consequences. The final signed agreement with the operator, who was the original consultant firm, (BECL) contemplates a cost to Government of \$2.4 million per year over a five-year period (with the possibility of renewal).

The Minister of Transport advised Cabinet as early as 2001, that Government had identified BECL as the “*preferred*” contractor. Financial Instructions do not address the issue of selecting a “*preferred*” contractor. However, W&E’s P.F.A. 2002 does describe a method of procurement by way of negotiation with a single entity. It states that a single entity procurement method is only appropriate if the contract relates to a national or operational emergency, a continuation of a pre-existing contract, or where there is only one single capable contractor. Consequently, we question the rationale upon which it was determined that BECL was to be the preferred contractor to provide a vehicle safety and emissions testing programme, especially since BECL subcontracted all aspects of establishing the programme including equipment design, supply and installation, and training.

## **Reviewing and Approving the Contracts**

### ***The Consultancy Agreement***

The initial consultancy agreement between the Government and BECL, signed in December 2006 provides for BECL to:

- oversee the construction, acquisition and demonstration phase for satellite emissions testing in the East End and West End of Bermuda;
- enter into a services agreement with TCD where BECL would provide TCD with an automated centralized inspection system for all motorized vehicles in Bermuda at inspection facilities to be located in the East End, West End and at North Street, Hamilton, Bermuda;
- enter into agreements with service providers to enable BECL to provide to the Government and TCD the design and implementation of all hardware, software and equipment for the two satellite testing stations and North Street Facility; and
- enter into agreements with specialists to provide programme training, contractor emission test personnel certification, an inspector's code of conduct, training plan and training course outline.

It should be noted that the agreement does not specifically require BECL to oversee the construction, acquisition and demonstration phase for the main testing station. This appears to be an oversight, as other parts of the agreement contemplate such action. The agreement was signed on behalf of Government by the Director of TCD. However, we did not see any evidence of a review of the reasonableness of the fees to be charged by BECL.

This agreement was not approved by Cabinet, despite Financial Instructions' requirement that any contract with a value of more than \$50,000 be so approved. Although Cabinet had previously approved the arrangement in principle, I question why the agreement was not submitted to Cabinet for approval.

### ***The Building Contracts***

As explained above, there was no formal tendering for the building of the two satellite facilities or the main testing facility, despite concerns that had been raised within Government and despite Cabinet's direction to openly tender the two satellite facilities.

As far back as 2003, when the original Cabinet approval was given to proceed, the estimated construction and equipment costs had been provided by CCCL. Although the estimated cost of construction of the three facilities (including equipment) had increased from \$5.3 million in July 2003 to \$12.9 million by September 2007, no evidence was provided to support any review of the costs by TCD.

In June, 2003, Cabinet authorized TCD to contract with a US company to provide project management services for the project, but that never happened. Unfortunately TCD did not have the capacity to do anything other than accept the costs put forward by BECL and CCCL.

There was no specific Cabinet approval of any of the construction contracts (although approval in principle to move ahead had been given previously). I question again why the building contracts were not submitted to Cabinet for approval.

Consequently, whilst retaining all of the risk, the above issues left the Government with no effective means of assessing the reasonableness of the contract prices.

Our review of the contract documents for the main testing facility reveals that BECL, acting as the “*Owner*”, signed a contract with CCCL, acting as the “*Contractor*”, to build the main testing facility on North Street for a fixed sum of \$8.95 million, despite not possessing final architectural drawings.

Within fifteen months of the contract being signed, there had been three change orders to the contract totaling over \$1.5 million. These changes are discussed below.

### ***The Operating Agreement***

In 2003, when the original Cabinet approval was given to proceed with the project, it was anticipated that the annual operating fee payable to BECL for operating the emission testing and vehicle inspection programme would be \$1.77 million. By the time the agreement was drawn up and signed in December 2008, the annual operating fee had increased to \$2.4 million. However, according to the Ministry of Tourism and Transport, despite Cabinet agreeing to the \$2.4 annual fee, the Ministry of Tourism and Transport was not funded the full \$2.4 million for fiscal 2009-10. Consequently, BECL agreed to be paid \$2 million in fiscal 2009-10.

Although the operating agreement was approved by Cabinet, the approval (on December 16, 2008) actually came one week after the Director of TCD had signed the contract on behalf of Government.

Our discussions with senior civil servants within the Ministry of Tourism and Transport reveal that no one within the Ministry assessed the reasonableness of BECL's annual fee. BECL did provide the Ministry of Tourism and Transport with a projected annual operating expense schedule which served as the basis for calculating the annual fee, yet no scrutiny of these expense projections ever took place.

We reviewed BECL's projected annual operating expenses and noted a number of questionable items. For example, the contract with BECL allows BECL to claim amounts relating to depreciation, repairs and maintenance and utilities, however, in reality these costs are being incurred by the Ministry of Tourism and Transport.



*Vehicle Testing Bay - North Street location*

## Reviewing and Approving Construction Contract Change Orders

There were a number of change orders during the construction of the main facility which were accepted by the Ministry of Tourism and Transport after the “fixed sum” contract for \$8.95 million had been signed in May 2007. Consequently, we would have expected to see an adequate level of due diligence when assessing the reasonableness of the change orders. We found, however, that no such due diligence was carried out.

Typically, a change order arises when work is added to, or removed from, the original scope of work. The cost of the change order is determined by subtracting the Contractor’s original carried sum (per the initial contract) from the cost of the revised scope of work.

We examined the largest change order #2, dated April 2008, for \$1.05 million which related to net “*extra costs not originally allowed for in previous estimates and additional requirements added by TCD*”. We noted that there were no details provided for “*Contractor Carried Sum*”.

Because no substantiation or backup was provided to support the original “Contractor Carried Sum” totals, and because the “Contractor Carried Sums” as stated on the change order bore no relation to the schedule of values used in the determination for drawdown claims, it was not possible to make the necessary comparisons as to what was initially included or excluded.

We understand that the schedule of values in the original contract contains aspects of work not included in the change order such as overhead and profit attachments. But, we were unable to determine any logical method as to how the Contractor Carried Sums were derived.

Had sufficient due diligence been carried out with respect to the vetting of change order #2, we believe it is likely that a number of items would have been questioned for appropriateness (because, on the face of it, they could relate to items that were already being carried in the original contract).

For example, the change order contained a \$120,000 claim for “*Interior Fit Out*” which included toilet partitions, appliances, hardware, shower doors, louvre doors and bathroom accessories. All of these items should have been included in the original bid since the original schedule of values carried the line items:

- “*Interior design fit out*”      \$ 237,204
- “*Furniture*”                      \$ 593,603
- “*Furniture*”                      \$ 87,410

We recommended that the Ministry of Tourism and Transport consider conducting a construction audit on all previously approved applications for payment and change orders in an effort to determine if the Ministry is entitled to any recoverable amounts. The Permanent Secretary agreed to take our recommendation under advisement.



*Boardroom - North Street location*

## Monitoring Contracts

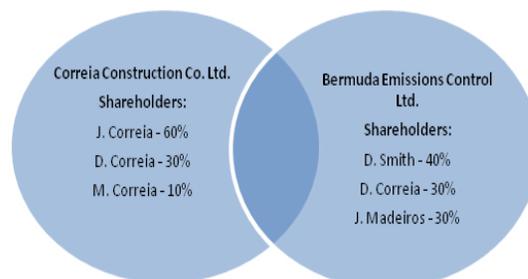
### *Contract Payments*

Once Government enters into contracts, it is important for Government to ensure that it is getting value for money. With respect to contracts for capital expenditures, Financial Instructions state that contract payments must be made only on certificates issued by the appropriate Accounting Officer or a private consulting engineer or architect engaged to supervise the contract.

The Accounting Officer or consulting architect or engineer is responsible for ensuring that payments to contractors comply with the terms of the contract and can be supported by work completed.

BECL engaged a private architect to certify all applications for payment, as required by all three construction contracts and Section 13.4 of Financial Instructions. It was understood that payments to BECL were approved by the Director of TCD (the Departmental Accounting Officer), relying on the certification of the architect engaged by BECL; however, a review of the supporting payment documentation reveals that BECL failed to obtain architectural certification on all applications for payment relating to the satellite facilities. Consequently, the Director of TCD failed to ensure that payments pertaining to the satellite facilities were fully supported by work completed.

The fact that BECL invoiced TCD for contractor costs that were never certified by an architect illustrates the very reason why it was inappropriate for the Director of TCD to place reliance on BECL given the known conflict of interest between BECL and CCCL (i.e. a common shareholder).



### *Capital Budget Figures*

The Ministry of Finance's Technical Committee is in charge of reviewing incremental funding requests for capital development projects. The Committee is headed up by the Minister of Finance and is composed of technical experts from the Ministry of Works and Engineering. The Committee submits its capital funding recommendations to Cabinet.

The incremental funding requests presented to the Committee were not appropriately reviewed for reasonableness. According to the Ministry of Finance's Director of Budget, the Committee placed full responsibility on the Ministry of Tourism and Transport to provide support for the capital budget increase requests. However, the Ministry of Finance accepted submissions from the Ministry of Tourism and Transport to support requests for additional capital funding, requests that were prepared by BECL.

The first incremental funding request was made in October 2006 and increased the capital budget from \$5.3 million to \$8.6 million. This increase was supported solely by billing projections generated by BECL. The second incremental request was submitted to the Committee in September 2007 but was supported only by contractor-generated cost estimates.

In addition, the September 2007 request does not completely explain why the Project's final budget as per the 2008-09 Approved Estimates of Revenue and Expenditure increased to \$14.25 million, as the 2007 application only supported a total capital expenditure of \$12.5 million. Neither the Ministry of Finance nor the Ministry of Tourism and Transport were able to justify the remaining \$1.75 million increase to the capital budget.

By the time the construction was finished, the final cost of the project totaled \$15.23 million. The project's final cost exceeded the capital budget by \$983,000. Discussions with the Ministry of Finance revealed that at no time during or after the completion of the project did the Ministry of Tourism and Transport notify the Ministry of Finance of the overspend.





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***Printed by the Bermuda Press Ltd.***