

Auditor General's Report on Anegada Ferry Services Contracts



Office of the Auditor General
Government of the Virgin Islands
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**AUDIT
OFFICE**
BVI GOVERNMENT

AUDIT REVIEW
Anegada Ferry Services Contracts

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AUDIT OBJECTIVES

1. The objectives of this audit were to evaluate the Smith's Ferry Services Ltd contract arrangement to provide service between the islands of Tortola and Anegada to determine the extent to which:

- i. Economy, effectiveness and efficiency were achieved from the award of the said contract.
- ii. The policies and procedures used to manage the contact were adequate.
- iii. Services being provided were in accordance with the contractual agreement.

AUDIT SCOPE

2. The audit focused on the examination of:

- i. the Smith's Ferry Services Ltd.- Anegada Ferry Services contract

and for completeness included a review of

- ii. the terms and condition of the Road Town Fast Ferry agreement and
- iii. the three submissions received in response to a November 2009 invitation to tender for the Tortola/Anegada ferry service.

AUDIT METHODOLOGY

3. The audit included an examination of relevant files and documents, review of Treasury payment records and interviews with key individuals who were associated with the execution of the said contract.

EXECUTIVE SUMMARY

- i. In August 2005 after air service between Anegada and Tortola was discontinued, the Government acted swiftly by engaging Smith's Ferry Services Limited to reestablish passenger service between the two islands, but in doing so it may have compromised elements of economy and efficiency in the contract terms and processes employed.

Economy

- ii. The contract with Smith's Ferry Services Limited contained a provision for compensation of fuel variations (in section 2.a refers) without any built in controls or limitations. This imported flexibility to the payments and led to an escalation in costs during the contractual term. During the calendar year 2008 fuel costs totaled \$138,739.00 and accounted for 46% of the payments made to Smith's Ferry Services Limited.
- iii. The collection retention allowance stipulated in section 2.c. of the contract was an unnecessary additional expense. This provision cost the Government some \$78,000.00 each year without providing any additional benefits.
- iv. The initial extension of the Smith's Ferry's contract in December 2005 and subsequent renewal in 2007 without the benefit of competitive tenders may have deprived the Government and the people of Anegada from obtaining better value on the service.
- v. The fixed flat rate contract awarded to Road Town Fast Ferry is an uneconomical option for the Government. The terms should be reconsidered to take into account the deduction of passenger fees collected.

Efficiency

- vi. The Ministry of Communications and Works failed to put mechanisms in place at commencement of the contract to enable the Government to monitor and gauge service level and satisfaction.
- vii. The absence of monitoring mechanisms meant that the Government was unable to verify the charges and information submitted by the ferry operators. Throughout the term of the contract the Government accepted invoices and statements for payment that were based on unverifiable data.
- viii. Inadequate system of records maintenance made it difficult to accumulate sufficient information to assess the service.
- ix. The contract was silent on issues such as (a) how auxiliary charges (eg. baggage/cargo etc.) would be treated, (b) cancellations and (c) penalties for nonperformance.

Effectiveness

- x. The retention of the ferry carrier to service the Tortola/Anegada route was effective in satisfying the Government's objective of restoring regular and reliable passenger service between the two sister islands.

BACKGROUND

4. In August 2005, the Federal Aviation Administration (FAA) issued a Notice of Emergency Suspension of Operating Certificate to several air carriers that operated to, from and within the Virgin Islands. This notice meant that the carriers would not be permitted to operate public air transportation while under suspension and resulted in the revocation of their operating certificates and the pilots' licenses by the FAA. Clair Aero a locally owned and operated air carrier was among those suspended. As a result of the actions of the FAA, the airline also lost its permits that had been granted by Air Safety Support International (ASSI) and the United Kingdom Department of Transportation thereby preventing it from operating in a United Kingdom Overseas Territory.

5. The grounding of Clair Aero removed the vital transportation link between Anegada and Tortola. Due to the special circumstances surrounding the situation Government was forced to make a quick decision to provide inter-island (Anegada to Tortola) transportation for the people and visitors of Anegada. Consequently the Ministry of Communication and Works entered into an arrangement with Smith's Ferry Service Ltd to provide passenger transportation service between Road Town and Anegada commencing in August 2005.

6. In order to formalize the arrangement with Smith's Ferry Services Ltd, a contract was prepared and signed on 19 September 2005 between the carrier and the Chief Minister, acting on behalf of the Government. This required Smith Ferry Services Ltd. to provide two round trips per day, three days per week for a period of four months in the first instance. After the expiration of the contract period, Smith's Ferry Services Ltd was allowed to continue operations under the terms of the expired agreement. On August 17, 2007 a second contract was signed with the Smith's Ferry Service Ltd, on substantially the same terms, to continue the service for an additional two years.

7. In addition to the ferry service, efforts were made during the month of August 2005 to secure airline service between Beef Island Airport and the Anegada Airport. The Government entered into negotiations with Island Bird Airline which submitted a proposal for the service but this never materialized.

8. Because the service was unexpected and unbudgeted, arrangements were made for the contract amounts payable to Smith's Ferry Services Ltd. to be covered by the Chief Minister's Office "Special Projects" budget. Resources for management and oversight of the service remained under the purview of the Ministry of Communication and Works.

CONTRACT COSTS

9. Prior to being grounded by the FAA in August 2005, Clair Aero had provided regular scheduled passenger service between Tortola and Anegada for several years.

10. The carrier owned two airplanes. The larger one accommodated eight passengers and the smaller one four. The carrier made two scheduled round trips three times a week (Monday, Wednesday, Friday) but was also available to do charters to Anegada and elsewhere as required. The airline charged \$60.00 per person round trip, \$40.00 one way and \$400.00 - \$800.00 for charter depending on which plane was used and the terms for return. The Government provided no subsidy.

11. After Smith's Ferry was engaged to pick up the service where Clair Aero had left off, their initial contract stipulated that the Government would guarantee the company \$3,000.00 per operating day (\$468,000 per year) with concessions for fuel variations. The guarantee required that the carrier would deduct from the \$3,000.00 any receipts collected from passengers. It also allowed for the company to retain the first \$500.00 of the amounts collected daily as extracted from the contract below.

2. c. The company shall deduct any such collections over and above \$500.00 collected per day from the guaranteed amount (\$3,000), and submit relevant invoice to the Government for payment of balance.

12. In effect, the basic annual guarantee would ensure that the carrier received no less than \$468,000 per year. This would comprise Government grant, passenger collections or a combination of both. In addition, the \$500.00 collection retention grant built into the contract secured a minimum annual payment of \$78,000 from the Government regardless of the passenger volume.

13. For the period August 2005 to August 2007 the payment submissions by Smith's Ferry Service indicated that the service was being well utilized, but the number of passengers was still insufficient to cover the guaranteed amount. During that two year period the Treasury Records show that the Government paid out a sum of \$481,757.00 for this service. This amount comprised of the guarantee to cover the shortfall in passenger collections, the collection retention grant of \$500.00 per day and fuel variation compensation. The averages for this two year period are shown below.

Smith Ferry Initial contract and extension	
August 2005-August 2007	481,757.00
Cost Per Month	20,073.21
Cost Per Week	4,632.28
Cost Per Day	1,544.09
Average per year	240,878.50

14. The subsequent contract with Smith Ferry contained the same remunerative provisions indicated above. For the period August 2007 to August 2009 an amount of \$522,405.60 was paid to the company. The averages were as follows:

Smith Ferry Second Contract	
August 2007- August 2009	522,405.60
Cost Per Month	21,766.90
Cost Per Week	5,023.13
Cost Per Day	1,674.38
Average per year	261,202.80

15. Because of shortcomings in the record keeping, full data providing the breakdown of the amounts into payment under guarantee, collection retention grant, and fuel variation charges

were not available. The Ministry was however able to compile this data for the calendar year 2008 as summarized below.

2008 Payment Activity	\$	%
Guaranteed Amount	468,000.00	-
Reported Collections	<u>384,835.00</u>	-
Payable under Guarantee	83,165.00	28%
Collection retention Grant	<u>78,000.00</u>	26%
Subtotal	161,165.00	
Fuel variation charge	<u>138,739.20</u>	46%
Total	<u>299,904.20</u>	100%

16. For 2008 approximately 46% of the sum paid to Smith's Ferry was for fuel charges. A further 26% was for the collection retention grant. Only 28% represented payments made in compliance with the \$3,000.00 a day guarantee.

17. The decision by Smith's Ferry to use a larger boat combined with rising fuel prices drove up the cost of the service. The records indicate that the price of fuel fluctuated upwards from \$2.10 (stated in the contract) to as much as \$4.52 in 2008.

18. Review of the information indicated that the major pitfalls to the Smith's Ferry arrangement were (a) the inclusion of a \$500.00 collection retention grant for which there was no logical explanation, and (b) the Government's agreement to cover the fuel variations charges, without any stipulated cap or limiting conditions, which could neither be monitored nor controlled.

19. In addition, the absence of Government controls and mechanisms to monitor and verify the information and amounts submitted by Smith's Ferry for payment meant that complete reliance was placed on the service provider's accuracy and integrity.

20. Upon expiration of the Smith's Ferry Contract in 2009 the services were put to tender and a temporary (interim) contract was awarded to Road Town Fast Ferry. This contract, which commenced on 1 November 2009, stipulated a flat, fixed payment of \$456,000 per annum. During the period November 2009 to January 2010 the Government paid out daily amounts of \$2,923.08 for a total of \$137,384.76 covering forty-seven (47) operating days or approximately sixteen weeks (payments included period in September before contract was signed). A summary of the averages is below.

Road Town Fast Ferry Temporary Contract	
	\$
Sep 09-Jan 2010	137,384.76
Cost Per Month	38,000.04
Cost Per Week	8,769.24
Cost Per Day	2,923.08
Average per year	456,000.48

21. In terms of costs, the significant difference between this contract and the one issued to Smith's Ferry was that Road Town Fast Ferry was allowed to receive the Government subsidy without having to make any reimbursement from the passenger fees they collected. In effect, the operators received passenger fees, Government subsidy and had a provision whereby they could also charge for fuel increase variations (although the fuel provision was not applied). Continuation of this arrangement under these terms would put the Government at a severe financial disadvantage.

CONTRACT MONITORING AND MANAGEMENT

22. Upon the initiation of the Smith's Ferry contract provisions were made to have the service coordinated and managed by the Ministry of Communication and Works. Despite this, no effective monitoring arrangements were put in place at the outset of the contract. The Ministry did not assign an employee to monitor the contract or implement ways to verify information submitted by the carrier. This shortcoming prevented the Government from ensuring that the terms of the contract were being carried out in an effective and efficient manner and that an appropriate service level and value for money were achieved throughout the life of the contract. It also resulted in:

- i. Submission of quantitative information which could not be verified. The contractor submitted cash reports to substantiate the amounts invoiced. These cash reports showed the numbers and class of passengers (adult, child, round trip etc.) There were no controls in place to ensure that the numbers submitted were accurate.
 - ii. Absence of qualitative information which is needed in order to gauge the level of customer satisfaction. Information about the service was not gathered from the customers. In addition constraints such as the absence of a passenger manifest prevented the ability to collect needed information.
 - iii. Continuation of service after the expiration of the contract without reviewing and updating the terms and requirements.
 - iv. Inadequate record maintenance. Information pertaining to this contract i.e. cash reports, invoices and other related correspondences were not kept together. The correspondences were kept along with other documents on a general file containing ferry related information. The cash reports which were submitted to the Premier's Office were processed by the accounts unit and stored along with other invoices received at the time.
23. The manner in which the related records/documents were kept made it difficult to obtain the information required to fully assess and analyze the effectiveness of the contract in a timely manner.
24. In November 2007 the Liaison Officer for Major Investment Projects in the Premier's Office was assigned to recommend a monitoring system and to oversee the implementation of the same.

25. This assignment yielded several recommendations for monitoring the service, including the implementation of a manifest, measures for Government oversight (spot checks etc.), fuel price monitoring/verification and protocol for cancellations. However, constraints on human resources and the nature of the service (inter-island transport) made it difficult to adequately monitor both qualitative and quantitative aspects of the contract.

26. The assigned officer did, however, interview passengers who travelled the route, conducted a few spot checks to ascertain the accuracy of the passenger information and examined invoices and cash reports submitted by Smith's Ferry Services Ltd. In addition, the Ministry requested and received statements from the fuel supplier verifying the changes in fuel prices.

SERVICE OUTCOME

27. The records indicated that Smith's Ferry Services Ltd. provided two (2) round trips three (3) times per week, as required by the contract agreement, and that this was done with very few cancellations.

28. A survey performed by the Liaison Officer indicated that passengers felt that the ferry service was valuable and should continue, even in the event that the air service was restored. Many expressed the view that the service provided was generally satisfactory but that there were some areas where improvements could be realised. These included:

- i. Improvements in punctuality;
- ii. Clarification and regularization of the baggage and cargo charges.
- iii. Implementation of a Sunday trip;
- iv. Implementation of a system for notifying passengers when a trip was cancelled.

29. Currently both carriers, Road Town Fast Ferry and Smith's Ferry Services Limited, are servicing the route between Tortola and Anegada. The former is doing so under a Government guarantee subsidy and the latter of its own initiative.

PROPOSALS FOR FUTURE SERVICE

30. Submissions received by the Government to a tender request issued in June 2009 and reissued in November 2009 provided for the same three days a week Anegada/Tortola service with additions for the Monday and Friday trips to be routed via Virgin Gorda. Three submissions were received. Two were from Smith's Ferry Services and one from Road Town Fast Ferry.

31. Submission 1A from Smith's Ferry Services offered to provide the service at a flat, fixed rate of \$2,500.00 per day or \$390,000.00 per year. There was no provision for deduction of passenger fees collected to reduce the Government payments. The proposal was silent on the treatment of collected passenger fare, with the implication that the operator expected to receive the full Government subsidy and retain all passenger collections.

32. Submission 1B which was also from Smith's Ferry Services tendered a fee of \$3,200.00 per day (\$499,200.00 per annum). The submission provided for deductions of passenger fees from the Government subsidy after retention of a \$500.00 per day fee. It also provided for the operators to be compensated for fuel variations above a stated \$2.10 per gallon and for fee adjustments (increases) where service days fell on public holidays. This proposal essentially mirrored the agreements under the previous Smith Ferry contracts but with an increase in the base amount by \$200.00 per day.

33. Submission 2 which was tendered by Road Town Fast Ferry proposed a flat fixed fee of \$36,000.00 per month or \$2,769.23 per day (\$432,000.00 per annum). There was no provision for deduction of passenger fees collected to reduce the Government payments. Like submission 1A, this proposal is silent on the matter of how collected passenger fees would be treated, but the reasonable inference is that the ferry operators expected that they would receive the full Government subsidy and retain all passenger collections as they had been doing under their short term contract.

34. Acceptance of either fixed rate submissions (1A or 2) without making any provision for the passenger fees collected is likely to put the Government at a severe disadvantage. Available data indicate that although the service may not be fully self supporting at the moment, it can likely generate enough revenue to cover 80% or more of the Government guaranteed sums. It is unfortunate that the tender documents did not provide any guidance in this area for the operators.

35. Prudence dictates that the Government either adopts a position whereby (a) the flat fee is paid to the carrier, but the Government retains all rights to passenger collections, or (b) a guaranteed amount is established against which the passenger fees are deducted and the carrier is allowed to keep all collections over and above the guaranteed amount. Option (b) is more desirable from the perspective that it could incentivize the carrier to provide a service that would encourage patrons, leading to increased returns.

36. A third option, option (c), would require the Government to allow the route to be serviced without subsidizing any of the carriers. This is an option that is worthy of consideration.

CONCLUSION

37. The 2005 contract issued to Smith's Ferry Services was awarded under circumstances that required quick and decisive action in order to ensure the continuation of passenger service between the islands of Tortola and Anegada. In acting swiftly, the Government was able to achieve this objective but in the process may have compromised elements of efficiency and economy in the contract terms and processes employed. With the review of the service the Government now has the opportunity to close some of the contractual loopholes that led to exorbitant costs in the initial agreements and at the same time secure improved transportation service to the residents and visitors of Anegada.

RECOMMENDATIONS

A number of the recommendations proffered by the Liaison Officer have already been implemented (eg. implementation of a passenger manifest and vendor submission of fuel changes). It is anticipated that these will help to improve the service efficiency. In addition, the following are recommended.

- i. If this has not already been done, an analysis should be performed by a competent source to determine the breakeven point for the ferry service between Tortola and Anegada (also taking into account the Virgin Gorda diversion on the two days indicated). This should be the basis against which the Government can determine the reasonableness of the service cost and upon which a Government guarantee could be based.
- ii. The contractual terms should be reviewed with a view to closing loopholes which expose the Government to increased and uncontrolled costs and to eliminate unnecessary and burdensome payments (such as the collection retention grant) which are not related to performance.
- iii. A clause should be included in the contract to regulate any auxiliary charges levied on passengers to ensure that these do not create hardship. This would include but not be limited to baggage, cargo and the proposed courier services.
- iv. A clear statement is required on how passenger fare collected will be treated under the contract.
- v. The contract should include penalties for nonperformance where service is unnecessarily interrupted.
- vi. Monitoring arrangement need to be better coordinated with increased involvement of the district officers on Anegada and Virgin Gorda.
- vii. Significant changes desired by the service provider (change in the type of vessel, change in scheduling, introduction of new auxiliary charges etc) must be first sanctioned by the Government.
- viii. Improvements are required in the record maintenance of all correspondence, records and statements related to this contract so that these can be readily accessible and easily analyzed.
- ix. Steps need to be taken to address the current situation whereby the Anegada/Road Town route is currently being over serviced (by two ferry operators). If an analysis (as suggested in recommendation i.) is carried out and the route is deemed profitable, the Government may wish to tender the right for one operator to service the route without offering a subsidy.