

Public Accounts Committee

Meeting Venue:

Committee Room 3 – Senedd

Meeting date:

Thursday, 12 June 2014

Meeting time:

09.00

Cynulliad
Cenedlaethol
Cymru

National
Assembly for
Wales



For further information please contact:

Fay Buckle

Committee Clerk

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Publicaccounts.comm@Wales.gov.uk

Agenda

1 Introductions, apologies and substitutions (09:00)

2 Papers to note (09:00) (Pages 1 – 4)

3 Senior Management Pay: Evidence Session 8 (09:00–10:00) (Pages 5 – 14)

Research Brief

Higher Education Sector

Professor Colin Riordan – Vice-Chancellor, Cardiff University

Jayne Dowden – Acting Chief Operating Officer, Cardiff University

4 Grants Management in Wales (10:00–12:00) (Pages 15 – 299)

PAC(4)–16–14(paper 1)

PAC(4)–16–14(paper 1A)

PAC(4)–16–14(paper 2)

PAC(4)-16-14(paper 3)

PAC(4)-16-14(paper 4)

PAC(4)-16-14(paper 5)

Research Brief

Sir Derek Jones – Permanent Secretary, Welsh Government

Damien O'Brien – Chief Executive WEFO

David Richards – Director of Governance

Peter Ryland – Deputy Director, Programme Performance & Finance

5 Motion under Standing Order 17.42 to resolve to exclude the public from the meeting for the following business: (12:00)

Items 6, 7 & 8

6 Grants Management in Wales: Consideration of evidence (12:00–12:20)

7 Senior Management Pay: Consideration of written evidence (12:20–12:40) (Pages 300 – 370)

PAC(4)-16-14(paper 6)

PAC(4)-16-14(paper 7)

PAC(4)-16-14(paper 8)

PAC(4)-16-14(paper 9)

PAC(4)-16-14(paper 10)

PAC(4)-16-14(paper 11)

8 Intra-Wales – Cardiff to Anglesey – Air Service (12:40–13:00) (Pages 371 – 375)

PAC(4)-16-14(paper 12)

Public Accounts Committee

Meeting Venue: **Committee Room 3 – Senedd**

Meeting date: **Tuesday, 20 May 2014**

Meeting time: **09.03 – 10.52**

This meeting can be viewed on Senedd TV at:

http://www.senedd.tv/archiveplayer.jsf?v=en_400000_20_05_2014&t=0&l=en

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Wales



Concise Minutes:

Assembly Members:

Darren Millar AM (Chair)
William Graham AM
Mike Hedges AM
Alun Ffred Jones AM
Julie Morgan AM
Jenny Rathbone AM
Aled Roberts AM
Gwyn R Price AM (In place of Sandy Mewies AM)

Witnesses:

Elaine Ballard, Taff Housing Association
Norma Barry, Tai Calon
Nick Bennett, Community Housing Cymru Group
Huw Vaughan Thomas, Auditor General for Wales, Wales Audit Office

Committee Staff:

Meriel Singleton (Second Clerk)
Claire Griffiths (Deputy Clerk)
Gareth David Thomas (Researcher)

TRANSCRIPT

View the [meeting transcript](#).

1 Introductions, apologies and substitutions

1.1 The Chair welcomed the Members to Committee.

1.2 Apologies were received from Sandy Mewies. Gwyn Price substituted.

2 Papers to note

2.1 The papers were noted.

3 Hospital Catering and Patient Nutrition: Update from Welsh Government

3.1 Members considered the letter from Professor White and noted that the Auditor General plans to review the recommendations contained in his both his report from 2011 and the Committee's report of 2012. The Committee agreed to return to this item in the autumn.

4 Meeting the Financial Challenges Facing Local Government in Wales

4.1 Members considered the correspondence received and agreed to undertake a short inquiry into this issue during the summer term.

5 Senior Management Pay: Evidence Session 7

5.1 The Committee took evidence from Nick Bennett – Chief Executive, Community Housing Cymru Group, Elaine Ballard – Chief Executive, Taff Housing Association and Norma Barry – Chair of Tai Calonon Senior Management Pay.

5.2 Nick Bennett agreed to send an analysis of the differences between the current charter on good governance and the draft code scheduled to replace the charter.

6 Motion under Standing Order 17.42 to resolve to exclude the public from the meeting for the following business:

6.1 The motion was agreed.

7 Senior Management Pay: Consideration of evidence received

7.1 Members considered the evidence received.

Public Accounts Committee

Meeting Venue: **Committee Room 3 – Senedd**

Meeting date: **Tuesday, 3 June 2014**

Meeting time: **09.00 – 10.32**

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Concise Minutes:

Private

Assembly Members:

Darren Millar AM (Chair)
William Graham AM
Mike Hedges AM
Alun Ffred Jones AM
Julie Morgan AM
Jenny Rathbone AM
Aled Roberts AM
Sandy Mewies AM

Witnesses:

Don Peebles, CIPFA

Committee Staff:

Fay Buckle (Clerk)
Meriel Singleton (Second Clerk)
Claire Griffiths (Deputy Clerk)

1 Introductions, apologies and substitutions

1.1 The Chair welcomed the Members to the meeting.

- 1.2 The Chair welcomed Don Peebles, Head of CIPFA Scotland and Martin Jennings from the Research Service to the meeting and invited them to present the training to the Members.

2 Professional Development Programme: Financial Scrutiny

- 2.1 Don Peebles, Head of CIPFA Scotland and Martin Jennings from the Research Service presented the training to the Members.

Document is Restricted

Sir Derek Jones KCB
Ysgrifennydd Parhaol
Permanent Secretary



Llywodraeth Cymru
Welsh Government

Darren Millar AM
Chair
Public Accounts Committee
National Assembly for Wales
Cardiff Bay
CF99 1NA

3rd March 2014

Dear Darren,

2013 Welsh Government Annual Report on Grants Management

Many thanks for your letter of 19th February 2014. I am grateful for the Committee's continued interest in improving grants management across the public sector in Wales. With your help, the Welsh Government has focussed on the detail of our grants improvement programme and been able to further develop our relationship with stakeholders and delivery partners.

The information requested in your letter is given below:

1. Information on the revised Code of Practice for Funding the Third Sector in Wales, how it differs from the previous Code and how compliance with the Code is to be monitored - See Annex A.
2. Details of the performance indicators being used by the Welsh Government to monitor the quality of its grants management processes - See Annex B.
3. Data on the volume and value of the local authority grants which have been qualified and how this compares with previous years - See Annex C.

I look forward to giving evidence to the Committee after Easter.

*Yours,
Derek*



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Annex A

Revised Code of Practice for Funding the Third Sector

Legislative framework

Section 74 of the Government of Wales Act 2006 (GOWA) requires Welsh Ministers to make a Scheme (“the voluntary sector scheme”). Sections 4a and 4b require that the Scheme must specify:

“4(a) how the Welsh Ministers propose to provide assistance to relevant voluntary organisations (whether by grants, loans, guarantees or any other means),

4(b) how the Welsh Ministers propose to monitor the use made of any assistance provided by them to relevant voluntary organisations...”

The Code of Practice for Funding the Third Sector (the Code) is the mechanism by which Welsh Ministers enact Section 74, 4(a) and 4(b) of the GOWA as required above.

The Code was previously revised in 2009 and, historically, published as a separate document in its own right. Changes over the last few years meant that the content of the Code had become inaccurate in places or lost relevance so that the document as a whole needed to be updated and improved.

Following consultation and dialogue with the Third Sector which is detailed below, a revised Code was published on 31 January 2014. The Code is now an integral part of the Third Sector Scheme, and formally annexed as such.

Process

The revised Code of Practice for Funding the Third Sector was developed in partnership with the Third Sector through the Third Sector Partnership Council's (TSPC) Funding and Compliance Sub-Committee over a period of six months. The revised document represents a substantial amount of partnership work with the Committee made up of Third Sector representatives and Welsh Government officials, including the Grants Centre of Excellence. It also takes into consideration responses to the Welsh Government's *Continuity and Change* consultation, which asked specific questions on broad proposals for inclusion in the Code.

This detailed work has also been contributed to by a range of Welsh Government departments, including the Grants Centre of Excellence, Value Wales and the Welsh European Funding Office (WEFO), as well as the Wales Audit Office.

Key changes

The Code has been revised and updated, with substantial new material. The principal changes are listed below:

- The new approach to the Code sets out the Welsh Government's intentions as well as expectations of the Third Sector; it is significantly more reciprocal than previously.
- The format of the Code has been overhauled. The previous Q&A format was not particularly useful and offered too much detail in some areas and not enough on more important areas.
- The Code is now written in two parts; part one sets out seventeen detailed principles and part two focuses on Funding and Commissioning in greater detail.
- The 17 principles are set out and explained in substantially greater detail than previously so that this key part of the Code is very largely new, although many of the principles themselves have been retained. They are listed below, with asterisks to denote those that were not included in the old Code at all:
 - I. Delivery of Strategic Policy Objectives
 - II. Respect for the Sector's Independence
 - III. Early and Constructive Dialogue
 - IV. Timely Decisions
 - V. Security of Funding
 - VI. Fair Funding Levels
 - VII. Value for Money*
 - VIII. Full Cost Recovery
 - IX. Commissioning Principles*
 - X. Payments
 - XI. Fair and Reasonable Treatment
 - XII. Joint Approach to Monitoring, Evaluation and Audit
 - XIII. Identifying Expertise and Developing Capability to Deliver*
 - XIV. Diversity*
 - XV. Innovation*
 - XVI. Good governance and due diligence*
 - XVII. Monitoring of the Code*
- Principle IV is of particular importance to the Sector as it relates to the notice period for changes to funding arrangements. The Welsh Government's commitment in this regard has been clarified and strengthened.
- Principle XVII establishes the basis on which compliance with the Code itself will be monitored, with reference to the roles of the Grants Sector of Excellence, the Third Sector Unit, the TSPC and its Funding and Compliance Sub-Committee.
- A new section on the Grants Centre of Excellence and grants management as well as Value Wales and procurement is included.
- There is clearer guidance on grants (definitions of core funding and project funding, hypothecated and un-hypothecated grants) and contracts and

procurement, as well as when these different funding mechanisms might be used.

- A new outcomes-based commissioning model is included to be used when Welsh Government departments are designing and developing services. This will be an enabler for co-design and co-delivery of public services in the future.
- Inclusion of the WEFO is a new addition.
- *Appendix 3: Compliance with the Code of Practice* has been clarified and strengthened. In this section, the Welsh Government advocates that other bodies funding the Third Sector should adopt the principles in the Code as best practice.
- A significant and new addition to this section is that when the Welsh Government provides hypothecated funding (for example to local authorities) or through a framework agreement (WGSBs), then compliance with the Code will be required through Terms and Conditions of funding.
- There is a stronger commitment (set out in Principle XVII) to address non-compliance with the Code and a requirement for explanation of the circumstances if non-compliance occurs. Previously, non compliance with the Code was reported via a designated Sub-Committee who then investigated and took action if appropriate. Anecdotal evidence suggested that this formal route was rarely taken by Third Sector organisations. The new Code enables more proactive monitoring of the Code, especially with regards to *Timely Decisions*, for example through spot checks.
- There are links to other useful documents such as minimum standards for managing grants, detailed guidance on Full Cost Recovery and new guidance on joint bidding.

Monitoring

The TSPC Funding and Compliance Sub-Committee is the key mechanism for monitoring the implementation of the Code.

In practice, the Welsh Government's Third Sector Unit and Grants Centre of Excellence will work closely to raise awareness of and monitor the Code through a number of ways:

- Delivery of joint training for Welsh Government grant managers to embed understanding of the principles of the Code and increase knowledge of the Third Sector more generally;
- Compliance included within minimum standards for grant management;
- Grants Centre of Excellence 'spot checks' to ensure that all funding is provided appropriately and compliantly, (for example monitoring Terms and Conditions);

- Annual exercise to determine whether Third Sector grant recipients have been provided with sufficient notice of funding arrangements;
- Annual Report on the wider Third Sector Scheme laid before the National Assembly for Wales (which from 2014 includes the Code of Practice for Funding the Third Sector);
- Reports of non-compliance to the TSPC Funding and Compliance Sub-Committee.

Annex B

Monitoring Performance and Quality Assurance

Minimum Standards for Grant Funding and Spot Checks

The Minimum Standards for Grant Funding (the Standards) were developed by the Grants Centre of Excellence in early 2011; they were initially used as an assessment tool during the peer review exercise undertaken in 2011-2012. Since then, the Standards have been developed and are now used by Internal Audit to assess grant funding programmes and are an accountability tool available to external stakeholders via the internet which can be viewed at:

<http://wales.gov.uk/funding/grants/contact-us/?lang=en>

They are also used as a performance monitoring tool to check business compliance with the Standards.

A rolling programme of spot check reviews was introduced in December 2012 to assess relevant processes and procedures of 10 grant funding programmes per month. This figure incrementally increased to 20 per month during the period to January 2014. The purpose of the checks is to consider grants processes and procedures and ascertain their compliance with the Standards. Grants Officials are asked to provide evidence of compliance with the Standards for a specific stage in the grant funding cycle and, in appropriate cases, whether they comply with the Third Sector Code of Practice also. Some examples are given below.

Grant Funding Stage	Example of evidence
▪ Intervention rationale	Ministerial submission/approval
▪ Planning Funding	Copy of the application form and supporting guidance
▪ Appraisal	Appraisal criteria and prioritisation method
▪ Approval	Formal recommendation based on the outcome of an appraisal
▪ Legal Documentation	Copy of the latest award letter to ascertain whether it is in the correct form, up to date, correctly drafted and recorded on the payment system Payment in advance template to ascertain whether a need for payment in advance has been demonstrated appropriately Third sector grants; when the organisation was informed of the funding

- **Monitoring and Payment** Evidence of monitoring of funding activities
Sample claim form
- **e-Grants Payment System** Was a new grant funding programme placed on
the system in a timely manner?
- **Third sector grants** Were external bodies notified within the required
time scale of the award of funding, change in
funding level or withdrawal of funding?

Quality Assuring Access to the Grants Payment System

To promote the correct and accurate use of the grants payment system, e-Grants, the Grants Centre of Excellence reviews documentation submitted for new funding programmes and for revisions to existing ones. If the request is for a new programme, or one that the Grants Centre of Excellence is not familiar with, a meeting is held with the relevant Branch and the processes and procedures assessed against the Standards. This process also ensures that officials involved in managing the grant funding programme concerned have completed all requisite training before system access is given.

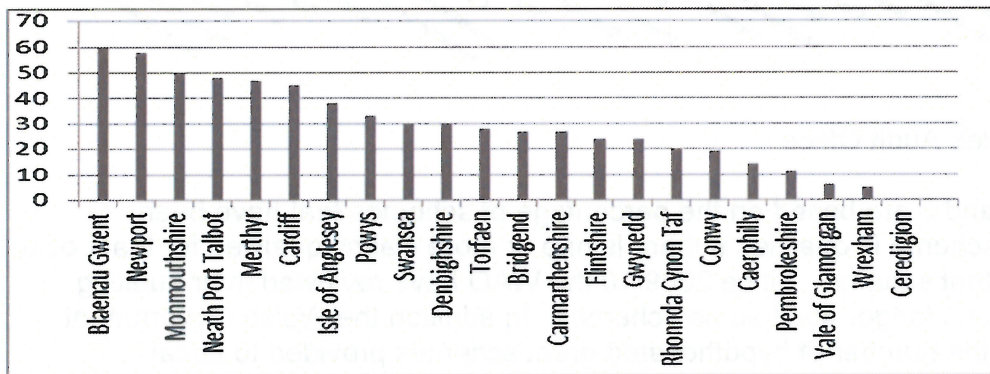
Annex C

Qualified Local Authority Grants

Whilst the programme to improve Local Authorities' grants management is on-going, the Welsh Government has continued to track the incidence of qualified or adjusted grant claims. The Welsh Government will also aim to satisfied that appropriate corrective action is being taken. This includes consideration of suspension or recovery of grants where the Welsh Government does not consider that the responses of individual Local Authorities are adequate.

The WAO report of November 2011 provided a breakdown of qualification by Authority. The graph of the findings provided in the WAO report is given in Fig 1.

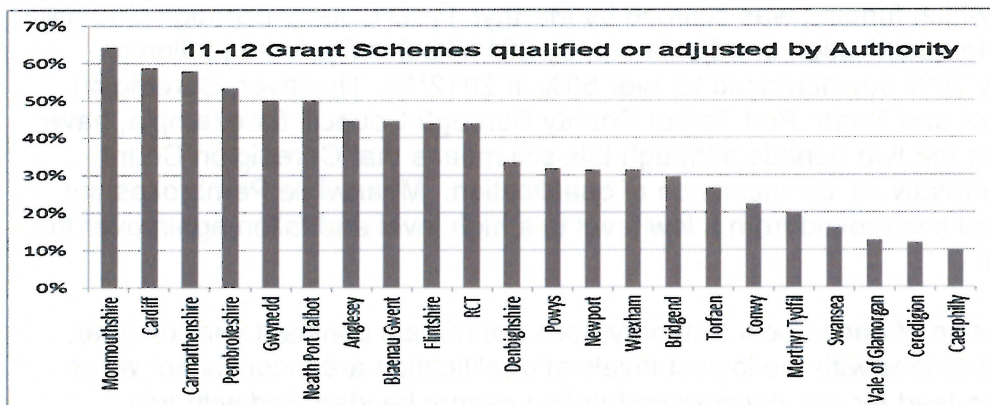
Figure 1. Wales Audit Office Graph of Adjustments and/or Qualifications by percentage of Schemes per Local Authority in Financial Year 2009/10



Source: Wales Audit Office Report - Grants management In Wales November 2011

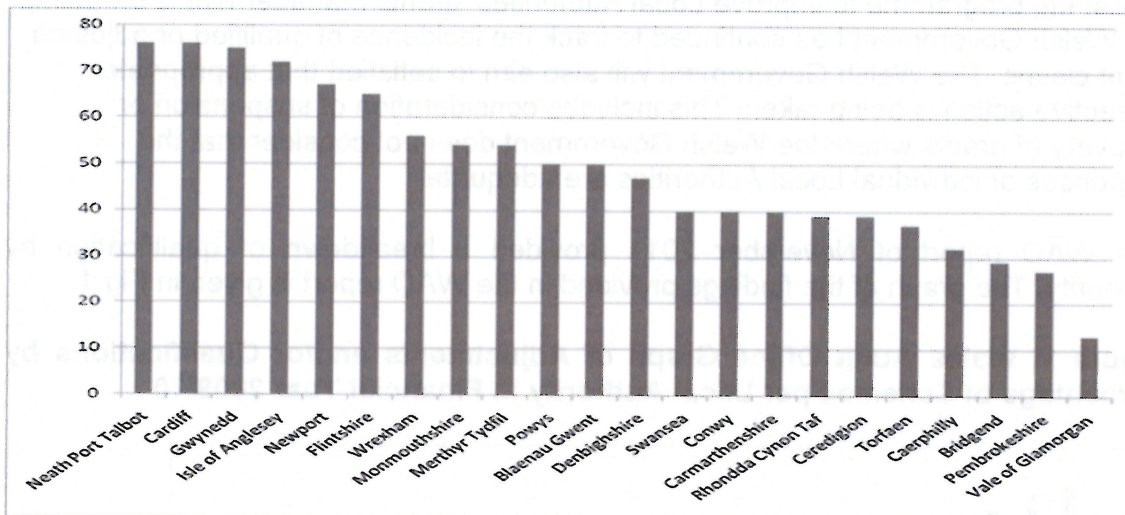
The WAO analysis of schemes qualified or adjusted by Local Authority for 2011/12 and 2012/13 are provided in Figures 2 and 3, respectively.

Figure 2. Wales Audit Office Graph of Adjustments and/or Qualifications by percentage of Schemes per Local Authority in Financial Year 2011/12



Source – Wales Audit Office

Figure 3. Wales Audit Office Graph of Adjustments and/or Qualifications by percentage of Schemes per Local Authority in Financial Year 2012/13



Source – Wales Audit Office

Figures 1, 2 and 3 are based on the percentage of schemes that have been qualified. A scheme is qualified if there is one or more claims qualified for that Local Authority for that scheme. Since 2009/10 the WAO have reviewed their auditing practices and no longer audit some schemes. In addition the Welsh Government has reduced the number of hypothecated grant schemes provided to Local Authorities. Therefore there has been a reduction in schemes audited by WAO from 35 in 2009/10 to 30 in 2012/13. These changes, and the fact that not all Local Authorities are awarded grant under every Welsh Government scheme, have had an impact on the percentage of qualified schemes reported. This in part accounts for the increase in percentages observed for 2012/13.

Analysis of audit certificates for the two periods 2011/12 and 2012/13 indicates that the percentage of qualifications has increased and the individual Local Authorities' positions varied significantly. For example, whilst in 2009/10, over 45% of the schemes for which funding was claimed by Merthyr Tydfil County Borough Council were subject to qualification or adjustment, by 2011/12 this figure had fallen to approximately 20% but increased to over 50% in 2012/13. However, Ceredigion County Council and Neath Port Talbot County Borough Council, for example, have increased over the two periods although this still means that Ceredigion County Council has a relatively low incidence of qualification. Meanwhile Pembrokeshire County Council has moved from a low level to a high level and fallen again over the same periods.

The rank position of each Local Authority does not remain constant year on year. The Local Authorities with the lowest levels of qualification are inconsistent which means that the lead for any consortium funding cannot be identified with any confidence.

For 2012/13, there were a total of 158 qualification letters issued against audit certificates which identified reductions in claims by some £13.7 million. This represents 1 claim in 4 being qualified in 2012/13 which remains consistent with the figures indicated in 2009/10. Whilst the performance of some Local Authorities has improved, this is not evident in the overall figures because others have worsened.

The training planned by the Welsh Local Government Association in conjunction with the Chartered Institute of Public Finance and Accountancy (CIPFA) during March 2014 is aimed at improving grant management standards in Local Authorities. This training, in conjunction with the training provided within the Welsh Government for grant officials, will have the effect of lowering the rates of qualification observed. However, this will take time to impact on audit certification and, consequently, it is unlikely that the impact of this training will be observed on qualification rates until the 2015/16 financial year.

In the intervening period, the Welsh Government is conducting a review of the audit certification system to ensure that it is effective and efficient and that all parties are achieving the best outcomes from the process.



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2013 Welsh Government Annual Report on Grants Management

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Foreword from the Permanent Secretary

The Welsh Government uses grants as a key means by which to achieve its policy objectives and a significant proportion of our total budget supports grant funding. Having good grants management arrangements is therefore extremely important to the Welsh Government.

In the past, there have been a few high-profile instances where our grants have not been managed properly and we have rightly come under considerable scrutiny. We have introduced measures to ensure that past mistakes are not repeated and this first annual grants management report sets out the action we have taken. The report is a public statement of our commitment to continue to improve grant funding arrangements in Wales.

The challenges associated with administering grant funding are significant and complex. We currently administer approximately 435 separate funding programmes, which vary from a few hundred to millions of pounds. Funding programmes, activities and receiving bodies vary and no two grants are the same. Consequently, we need to have measures in place that are proportionate to the risks involved yet maintain consistency in our approach.

Whilst it is universally understood that the Welsh Government is accountable for the public purse, we must also consider the needs of those seeking funding. Grant applicants must be assured that the information they are asked to provide is relevant and necessary to the decision-making process and have confidence that their applications will be appraised in a fair and consistent manner. I believe the steps we have put in place will help provide these assurances.

I am grateful to the Public Accounts Committee for its continued interest in improving grants management. With its help we have been able to focus on the detail of our grants improvement programme and develop our relationships with stakeholders and partners. I am pleased with the progress that has been made towards addressing issues identified previously by the Wales Audit Office and the Public Accounts Committee, but I know that there is still some work to do to embed these principles and practice across the Welsh Government.

This first annual report provides details of the current grants administered by the Welsh Government and sets out what has been achieved over the past 18 months to help improve standards of administration. The improvement work undertaken provides us with a strong foundation on which to build and details of the actions we are undertaking next are also included in this report. Our approach is to respond positively to changing policy needs and to support Ministers in delivering their programme for Government. Looking forward, future work will include consideration of the outcome of the work of the Commission on Public Service Governance and Delivery. In all this work, I am determined that our grants management should be as consistent, robust and well managed as possible.



Sir Derek Jones
Permanent Secretary to the Welsh Government

SECTION 1: INTRODUCTION AND BACKGROUND

Introduction

1.0 The Annual Grants Management Report provides an overview of the current grant funding provided by the Welsh Government and gives an update on what has been achieved since the introduction of a programme to improve standards of our management of grants.

1.1 This report is a direct consequence of the Public Accounts Committee (PAC) recommendation for a comprehensive report on Welsh Government grant activities¹. In Section 5, key themes are covered that have been identified by Wales Audit Office (WAO), in the PAC sessions and its interim and final reports on grants management. Progress against specific recommendations by the WAO and PAC is provided in the annexes.

1.2 In September 2010, the Grants Management Project (GMP) was established to implement improvements to grants management across the Welsh Government. The decision to initiate the project was as a result of Welsh Government recognising that grants management was not undertaken proportionately and consistently across the organisation. The project was also established to review and address issues that had been highlighted in some high profile cases where grants had been provided to organisations where questions about their management or viability had been brought to the attention of the Welsh Government.

1.3 The aim of the project was to provide a robust system for managing and monitoring grants that was fit for purpose, but also to support officials involved in the delivery of grants by providing guidance, training and sharing best practice. The initial step was the creation of the Grants Centre of Excellence, an internally facing team set up to standardise procedures and provide guidance, expertise and knowledge to support the grant processes.

1.4 The Grants Centre of Excellence is currently working with officials from senior management through to grant practitioners by providing awareness sessions and online training. As the project proceeds and improvements are implemented, the role of the Grants Centre of Excellence will evolve from a guiding hand to one of monitoring and ensuring compliance.

1.5 In the four years that the project has been in place, there have been notable improvements in the systems and processes:

- establishment of the Grants Centre of Excellence to provide advice, expert support and guidance for all non-procured funding;
- minimum standards for the management of grant funding;
- improved training for grant officials;
- spot checks of grants to ensure compliance with minimum standards;
- improved sharing of corporate intelligence via the existing IT system; and,

¹ Public Accounts Committee Report – Grant Management in Wales - Interim Report – August 2012

- standardisation of the Award Letter.

1.6 Welsh Government's assessment of the risk associated with hypothecated grant administration has decreased from 'high risk' to 'medium risk', following the introduction of improvements. Whilst there will always be a level of risk associated with the provision of grant funding, the Welsh Government aims to reduce risk further, by undertaking the activities highlighted in this report.

Background

1.7 Grants are an important vehicle to deliver Welsh Government's priorities as laid out in the Programme for Government. They enable funded organisations to provide specific services to the people of Wales. Grants both initiate and sustain significant levels of economic and social activity. They also represent a significant investment of taxpayers' money, with some £13.2bn being invested in this way annually.

1.8 The Welsh Government has adopted the following high-level definition of 'grant' to accommodate the breadth of different payment types made: all non-procured payments to an external organisation or individual for activities, which are linked to delivering Welsh Government policy objectives and the discharge of its statutory obligations.

1.9 Grants can be sub-divided into hypothecated and unhypothecated grants. Hypothecated grants are for a specific purpose and are awarded to organisations to deliver specific policy objectives. Unhypothecated grants are mainly provided by the Welsh Government to deliver statutory obligations; largely to Local Authorities and the NHS. Unhypothecated grants can be used by the recipient organisation in whatever manner it wishes to meet local objectives and services, subject to the delivery of its statutory responsibilities.

SECTION 2: FUNDING FROM THE WELSH GOVERNMENT

2.0 This section provides an overview of Welsh Government grant funding including an overall perspective on grants, a breakdown of grants to the sectors and information on Structural Funds provided by the Welsh European Funding Office (WEFO).

i. The Overall Picture

2.1 The Welsh Government currently operates around 435 separate schemes which have provided around £39.9bn of funding over the 3 years to March 2013 (see Figure 1). Due to the dynamic nature of grants, the number of schemes operating at any point in time can vary considerably. The schemes currently in operation provide approximately 20,000 individual offers of grant per annum.

2.2 The figures within this report are derived from a combination of data provided by the Welsh Government's e-Grants (the grant payment system), departmental and financial systems. The financial figures are the total level of grant funding provided by the Welsh Government departments, including European funding. No distinction is made between revenue and capital expenditure.

Figure 1: Total Welsh Government Grant Funding by Financial Year

	2010/11	2011/12	2012/13
Level of grant provided (£bn)	13.6	13.1	13.2
No. of grant offers per year	29,774	24,443	20,172
Approx. no. of schemes per year	517	456	435

Source: Welsh Government Finance System based on nominal codes and e-Grants system

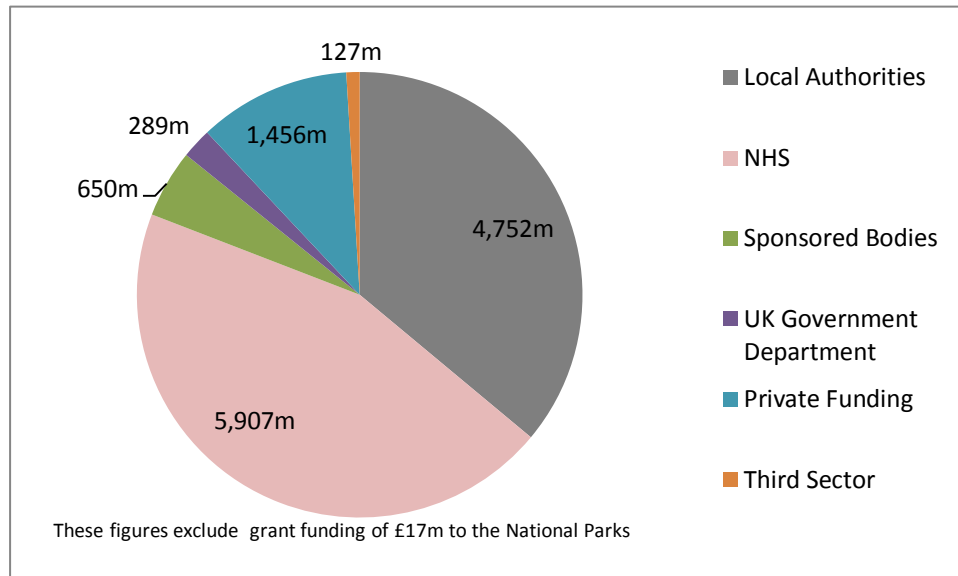
2.3 Included in Figure 1, and throughout this report, is the funding passed on to third parties by the Welsh Government, which originates from grant funding from WEFO. Direct funding from WEFO to external grant recipients is, however, excluded from this report. These Structural Funds are worth over £1.8bn for the seven year European Union (EU) funding period from 2007 to 2013 inclusive and are administered through WEFO.

2.4 With the difficult economic climate that has been evident over recent years, the trend shown in Figure 1 indicates the continued Ministerial commitment to grants as an important vehicle to deliver Welsh Government's priorities as laid out in the Programme for Government. However, Figure 1 demonstrates significant reductions in the number of schemes (15.9%) and the number of grant offers (32.2%) over the last three years. This is due to the commitment from the Welsh Government to reduce the number of grants provided. This reduction has come about due to an increase in collaborative working between Local Authorities resulting in schemes issuing 4 or 5 award letters instead of 22 and through the duration of grant funding

being increased rather than offered on an annual basis. This trend is important in the context of the Welsh Government’s objective to reduce grant administration costs.

2.5 The Welsh Government provides grants to three main sectors, which are public (local government, the National Health Service (NHS), Government Departments and sponsored bodies), private and Third Sector (voluntary organisations, social enterprises, community organisations etc.).

Figure 2: Total Welsh Government Grants for 2012/13 by Sector



Source: Welsh Government Finance System based on nominal codes

2.6 The majority of public-sector grant funding is through unhypothecated grants to both local government and the NHS. Hypothecated grants are also provided to these bodies, as well as to UK Government Departments to support specific UK objectives. In addition, funding is provided for organisations collectively known as Welsh Government Sponsored Bodies (WGSB), which are non-departmental public sector bodies directly funded by the Welsh Government to deliver policy, services and statutory requirements.

2.7 The private sector funding category includes both funding to business and to Higher and Further Educational Institutions (HEI & FEI). Further grant funding for education is included in the public sector, sponsored body category, where the Higher Education Funding Council for Wales (HEFCW) provides a significant proportion of funding to HEIs. Funding for schools is included under Local Authorities. Further details on funding education are provided in paragraphs 2.33 to 2.36.

2.8 The Third Sector is defined as independent, non-governmental bodies, established voluntarily by citizens, who are motivated by the desire to further social, cultural or environmental objectives and are committed to reinvesting their surpluses into their objectives. The sector includes not-for-profit organisations, voluntary organisations, charities and housing associations. Funding to the Third Sector is

usually hypothecated grant for specific activities. Further detail is provided in paragraphs 2.37 to 2.51.

ii. Public Sector

2.9 Overall public sector grant funding includes Local Authorities, the NHS, UK Government Departments, WGSBs and National Parks. The grants provided to this sector are approximately 90% of the total grant spent by the Welsh Government. The majority of this is unhypothecated grant used by Local Authorities and the NHS to provide services; this accounted for £8.4bn in 2012/13. The remaining £3.7bn in 2012/13 was provided under hypothecated schemes to deliver specific projects and activities associated with the delivery of ministerial policies. Of the hypothecated grants to Local Authorities and NHS, a proportion of the funding was passed on to third party organisations (including the Third Sector).

Figure 3: Welsh Government Total Grant Funding to the Public Sector by Financial Year

	2010/2011	2011/2012	2012/2013
Level of grant provided (£bn)	12.1	11.7	11.6
Level of grant to Local Authorities (£bn)	4.9	4.6	4.8
Level of grant to NHS (£bn)	6.0	5.9	5.9
% of total grant funding in Wales	89%	89%	88%

Source: Welsh Government Finance System

2.10 Whilst the level of funding to the public sector has decreased slightly over the three year period, the percentage of total grant funding remains relatively constant.

Local Authorities

2.11 A large proportion of grant funding in Wales is given to Local Authorities as unhypothecated grant under a combination of Revenue Support Grant (RSG), general capital grant and redistributed non-domestic rates. Around £4.8bn was distributed in this way in 2012/13.

2.12 In 2012/13, Local Authorities had access to more than £735m provided by more than 50 hypothecated grants. Examples include 21st Century Schools grant, the Better Schools Fund, Learning Disability Strategy, grants to promote joint working in schools and funding to support pupils from ethnic minority backgrounds.

2.13 The Welsh Government is committed to reducing the number of hypothecated grant schemes provided to Local Authorities. Wherever possible the funding for specific activities is transferred into the RSG which enables Local Authorities to determine local priorities and to use the funding as appropriate. This also eliminates the administration costs associated with specific grants for both the Local Authority and the Welsh Government. However, specific grants are still required where the

implementation and delivery of specific Ministerial priorities need to be undertaken by Local Authorities. This enables outcomes to be measured against the specific policies.

Figure 4: Welsh Government Grant Funding to Local Authorities by Financial Year

	2010/11	2011/12	2012/13
Level of grant provided (£m)	4,899	4,627	4,752
Level of unhypothecated grant (£m)	4,051	4,008	4,017
Level of hypothecated grant (£m)	848	619	735
% Hypothecated grant	17%	13%	15%

Source: Welsh Government Finance System based on nominal codes and the Unitary Authority element of the Revenue Support Grant settlement.

2.14 The percentage of hypothecated grants increased slightly in 2012/13 in comparison with the previous year due largely to an increase in specific projects for educational activities, where priority was given to funding for raising educational standards in schools. Hypothecated grants include the Pupil Deprivation Grant and School Effectiveness Grant. These are the Welsh Government's principal means of providing support for measures to achieve its three national priorities for schools: improving standards in literacy; improving standards in numeracy; and reducing the impact of poverty on educational attainment.

2.15 Concerns were raised by the PAC at its evidence session on 8 May 2012 about the audit certifications and qualifications associated with specific grant schemes providing funding to Local Authorities. The WAO report of November 2011 provided a breakdown of qualification by Local Authority. Following the release of the report, the Welsh Government has worked closely with the WAO to ensure the effectiveness of the audit certification work undertaken by the WAO. Copies of audit certificates are provided to the Welsh Government in order to ensure that appropriate consideration of the detail of qualifications has been made and appropriate action taken where required.

2.16 The importance of audit certification has been highlighted within the Welsh Government via an awareness session held by the WAO in March 2013. Grant managers providing hypothecated grants to Local Authorities and the NHS were asked to attend. The session highlighted the importance of audit certification, why qualifications might be made on the certificate and what actions should be considered.

2.17 Officials from the Welsh Government have also worked with the Welsh Local Government Association (WLGA) to provide support to Local Authorities to improve grants management. The Welsh Government has helped the WLGA to continue to promote and disseminate good practice on its dedicated grants management

webpage. In parallel, the WLGA is working with the WAO on its good practice events and other public service partners such as the Welsh Council for Voluntary Action (WCVA) on the appropriateness of grant funding compared with other mechanisms.

2.18 Whilst the programme to improve Local Authorities' grants management is ongoing, the Welsh Government will continue to track the incidence of qualified or adjusted grant claims. Working with the WAO, Welsh Government will ensure that appropriate corrective action is taken. This includes consideration of suspension or recovery of grants where the Welsh Government does not consider that the responses of individual Local Authorities is adequate.

NHS

2.19 The Welsh Government's Department for Health and Social Services is responsible for exercising strategic leadership for, and management of, the NHS in Wales and is responsible for the overall stewardship of NHS funds. Direct delivery of services is provided via seven Local Health Boards and three NHS Trusts. The key responsibilities of the department are to promote, protect and improve the health and well-being of everyone in Wales, ensuring high standards of safety and quality, and paying particular attention to reducing health inequalities.

2.20 Funding the NHS in Wales covers the running costs for staff, services and accommodation, together with the capital funding for individual projects. Funding also covers payments to independent contractors such as doctors, dentists, pharmacists and optometrists.

2.21 Revenue funding is primarily issued as unhypothecated expenditure and is agreed at the start of the financial year and drawn down as required each month by NHS organisations. The majority of capital funding is agreed as part of the All-Wales Capital Programme, which is also unhypothecated, however an element is also issued as discretionary, hypothecated funding.

Figure 5: Welsh Government Grant Funding of NHS by Financial Year

	2010/11	2011/12	2012/13
Level of grant provided (£m)	5,961	5,914	5,907
Level of unhypothecated grant (£m)	5,411	5,535	5,575
Level of hypothecated grant (£m)	550	379	332
% Hypothecated grant	9.2%	6.4%	5.6%

Source: Welsh Government Finance System based on nominal codes and the NHS Settlement.

2.22 Whilst grant funding to the NHS has remained level over the three year period, there has been a reduction in hypothecated grants to the NHS. This has resulted in decreased administration costs.

UK Government Departments

2.23 Where Welsh Government Ministerial priorities are aligned with wider UK Government priorities, then the Welsh Government provides hypothecated grants to UK Government departments. This funding is then utilised to ensure increased value for money in delivery of key policies.

2.24 For example, as part of the International Education Programme the Welsh Government has a Memorandum of Understanding with the Department for Business, Innovation and Skills and the other devolved administrations on delivering the UK China Partnerships in Education Programme (UKCPIE) and another for delivering the UK India Education Research Initiative (UKIERI). Whilst the level of grant provided to the Department for Business, Innovation and Skills is negotiated for the UKCPIE programme, the UKIERI programme is paid on a Barnett formula basis directly to the British Council in India. Figure 6 shows a decrease of funding provided over the three year period due to increased pressure on budgets.

Figure 6: Welsh Government Grant Funding of UK Government Departments by Financial Year

	2010/2011	2011/2012	2012/2013
Level of grant provided (£m)	466	452	289

Source: Welsh Government Finance System based on nominal codes

Welsh Government Sponsored Bodies (WGSBs)

2.25 The Welsh Government provides funding for various bodies collectively known as WGSBs. Each has its own constitution, governance and management structure including a Principal Accounting Officer, and is funded to deliver the objectives for the particular year as set out in the body’s annual remit letter provided by the Welsh Government. These include Sport Wales, Arts Council for Wales, Natural Resources Wales, National Library of Wales, National Museum Wales and Royal Commission on the Ancient and Historical Monuments of Wales. Figure 7 provides details of the funding provided by year. Some £2,076m has been provided to these bodies over the period 2010/11 to 2012/13. An increase in the value of hypothecated grants during the period is a consequence of Welsh Government being focused on specific deliverables associated with Programme for Government where WGSB’s are taking the lead. A decrease in funding is due to increased pressure on budgets.

Figure 7: Welsh Government Grant Funding to WGSBs by Financial Year

	2010/2011	2011/2012	2012/2013
Level of grant provided (£m)	752	675	651
'Grant in aid' core grant (£m)	656	563	530
Hypothecated grants (£m)	96	112	121

Source: Welsh Government Finance System based on nominal codes

iii. Private Sector

2.26 The private sector consists of funding to businesses and direct funding from the Welsh Government to FEIs and HEIs.

Funding to Business

2.27 Grant funding to business covers a wide range of activities including business funding, training, tourism, business start-ups and research, development and innovation. This type of funding is used for developing the economy of Wales by enabling businesses to undertake projects that create or safeguard jobs. Grants can also be used to attract businesses into Wales. A few examples of some of the schemes that are offered are highlighted in the following paragraphs.

2.28 Business funding is currently provided through the Welsh Government sector teams via the Wales Economic Growth Fund (WEGF). The first tranche of WEGF, issued in 2012, has provided £31.5m of grants. The second tranche of this scheme is currently in operation.

2.29 Through the Tourism Investment Support Scheme some £10.4m has been invested in tourism upgrading and new capacity projects, over the three years to 2012/2013.

2.30 Research, Development and Innovation Grants (part European funded see paragraph 2.3) totalling over £20m have been paid over the last three years, specifically to businesses looking to innovate on the world stage.

2.31 The Redundancy Action Scheme (ReAct) (part European funded see paragraph 2.3) helps people affected by redundancy gain new skills and encourages recruiting employers to employ a redundant worker. Funding of £18.9m has been provided via this scheme to employers over the three years to 2012/2013.

Figure 8: Welsh Government Grant Funding to Businesses by Financial Year

	2010/11	2011/12	2012/13
Level of grant provided (£m)	434	431	582

Source: Welsh Government Finance System and e-Grants payment system

2.32 There has been a significant increase in funding to businesses in 2012/13; this is mainly due to the Welsh Government's priority to increase economic development and jobs within Wales.

Educational Institutions

2.33 Funding to support the education sector is complex. The majority of funding to the education sector, particularly schools, is distributed through RSG which is paid directly to Local Authorities. Hypothecated funding for schools is also provided to Local Authorities. Meanwhile, the majority of the grant funding for the higher education sector is paid to the Higher Education Funding Council for Wales (HEFCW). The funding provided to schools and HEFCW is included in the public sector category detailed previously.

2.34 Whilst there is considerable grant funding for education via the public sector, as detailed above, all additional hypothecated funding for HEIs and FEIs is classified as funding to the private sector. The core funding to FEI has been set for three years and uses a formula calculation based on a number of variables.

2.35 The demand-led statutory student support funding for Higher & Further Education learners is delivered by the Student Loans Company (SLC). The SLC is funded by the Welsh Government by payment of a monthly claim, which is based on part actuals/part forecasts, to ensure SLC has sufficient available funds to administer government funded fee-related loans and grants directly to students, universities and colleges for Welsh students.

2.36 Additional hypothecated grants are also provided to FEIs and HEIs to deliver specific projects or activities. These grants include Sêr Cymru which is a £50m scheme to enhance and build on the research capacity in Wales, to attract world leading scientists and their teams, and to support the establishment of three National Research Networks.

Figure 9: Welsh Government Direct Grant Funding to Further and Higher Education by Financial Year

	2010/2011	2011/2012	2012/2013
Level of grant provided (£m)	914	865	874

Source: Welsh Government e-Grants payment system

iv. Third Sector

2.37 The Welsh Government recognises that the Third Sector (voluntary organisations, social enterprises, community organisations etc.) has a very important part to play in helping it achieve its objectives under its Programme for Government. Grants awarded to this sector must comply with the Code of Practice for Funding the Third Sector (January 2009). That document, and the way in which the sector is funded, is currently under review. An updated version of the Code of Practice and a new strategy directed at matching the strategic key priorities of the Government will be released in early 2014.

2.38 The Welsh Government provides four types of grant funding to the Third Sector:

- strategic core funding of national organisations;
- specific programme funding at national levels;
- support to partnerships or national (all-Wales) intermediary bodies in order for them to support specific projects at a local level; and,
- start-up funding for national organisations or networks or through intermediaries, for local organisations.

2.39 The initial assessment of grant funding to the Third Sector indicated that £127m was provided in 2012/13 (Figure 2). These figures were based on the finance codes (nominal codes) associated with grants provided to the Third Sector through the payment system. However, following further analysis by the Third Sector Unit and the finance team, the way that Third Sector organisations are identified in the finance system has been reviewed and revised. Organisations such as charitable schools and some not-for-profit companies have been re-categorised from private sector to Third Sector. The categorisation of the organisations has been agreed with the WCVA. Funding can be tracked more accurately through this revised system and therefore these changes have resulted in a more detailed breakdown of grant funding to the Third Sector. Reports recently made available indicate that the actual level of grant funding following the re-categorisation for the last three financial years to the Third Sector is as shown in Figure 10.

Figure 10: Welsh Government Grant Funding to the Third Sector by Financial Year

	2010/11	2011/12	2012/13
Level of grant provided (£m)	350	303	265

Source: Welsh Government Finance System based on organisation name

2.40 The reported reduction in funding reflects a wide range of issues and circumstances across many Welsh Government departments due to the overall economic situation rather than any concerted policy or process. The reduction in UK Government funding for Wales has inevitably impacted on Welsh Government funding across the board to public, private and the Third Sector. Changes include project funding coming to a natural end; agreed reductions in continuing funding (for example, core funding for Third Sector infrastructure bodies was reduced by 8%); and savings achieved through procurement processes. The Welsh Government will work with the Third Sector Partnership Council Funding and Compliance Sub Committee to monitor this situation over the coming year and report on the overall comparisons in our next annual report on grants management.

2.41 There is a duty upon the Welsh Government under its Code of Practice for Funding the Third Sector (2009) to ensure that decisions to provide grant funding or not, is advised to the recipient Third Sector organisation by 31 December prior to the commencement of each financial year unless, in exceptional circumstances, notice has already been given of an alternative timescale.

2.42 The identification of breaches of the Code relies on the reporting of instances where the Code has not been complied with via the Third Sector Partnership Council's (TSPC) Funding and Compliance Sub-Committee, or directly from Third Sector organisations. There were no identified breaches reported to the Sub-Committee for the financial year 2011/2012. It has been recognised that the best practice set out in the Code has not always been implemented, and that there was therefore a need for clearer guidance and improvements to the procedures around, for example, notification of funding alongside a more proactive approach to achieving the standards and commitments set out in the Code.

2.43 Whilst the existing Code of Practice covers the years referred to in this report, the new Code of Practice – which is currently the subject of further consultation with the TSPC – will be more robust on this issue. The draft revised Code includes a commitment to improved clarification in the way in which the Code itself is monitored. In the spirit of this proposed commitment, information on compliance with the new Code is now being gathered pro-actively.

2.44 The Welsh Government is now working to this new standard, which will be reflected in the new Code of Practice. Welsh Government will continue to develop a range of monitoring tools to assess future compliance with the Code. Further improvements are anticipated once the new Code of Practice comes into operation.

2.45 Through discussions with the Funding and Compliance Sub-Committee of the TSPC, it has been agreed that proactive monitoring of compliance with the Code will be an additional fundamental principle of the revised Code of Practice for Funding the Third Sector in Wales. There is a commitment to address non-compliance and where there is non-compliance, an explanation of the circumstances will be provided to the Funding and Compliance Sub-Committee and action will be taken where appropriate. This function is being undertaken by Welsh Government's Third Sector Team and involves direct engagement with all grant funding departments to ascertain, via information contained in detailed returns, whether each has complied with the Code.

2.46 Random sampling of grant recipients is also to be undertaken to monitor compliance with the Code; 10% of the approximately 900 Third Sector organisations funded per year is being sampled by the Third Sector Team. This exercise is separate from the spot checks that the Grants Centre of Excellence is undertaking. The information gathered will also be used to further inform the content of future grants annual reports.

2.47 This proactive approach will mean that identifying breaches of the Code will be much less reliant on grant recipients reporting concerns or making formal complaints. Further consideration will also be given to other mechanisms for testing compliance with the Code, such as making provision for grant recipients to raise concerns anonymously.

2.48 The consultation also included proposals to strengthen local compacts, between the Third Sector and Local Authorities, which improved guidance and monitoring forms an important part. Such guidance will provide an opportunity to

highlight the revised Code as a good practice model which Local Authorities and other public sector partners should consider adopting for their own use.

2.49 Where a clear financial reason is established, payment of grants can be made in advance to Third Sector organisations. A payment in advance template has been developed by the Grants Centre of Excellence in conjunction with the Funding and Compliance sub-committee of the TSPC. The template is completed by Third Sector organisations and is assessed by grant managers under advice from the Grants Centre of Excellence. This enables those organisations that have not built up reserves to be paid in advance in line with Welsh Government policy.

2.50 The Payment in Advance Template has been used in relation to a number of grants across the Welsh Government. No issues have arisen with the template in relation to the revenue support Welsh Government provides for core funding. In terms of capital support, the approach adopted is to consider requests for payment in advance on a project-by-project basis and only assisting where genuine need can be proven.

2.51 This template will continue to be reviewed regularly by the Welsh Government to ensure that it remains fit for purpose. Any problems associated with the template will be reported in future editions of this annual report and also to the Funding and Compliance sub-committee of the TSPC. Any changes to the template will be discussed and agreed with the sub-committee prior to implementation.

v. Structural Funds

2.52 Although the management of structural funds is not within the remit of the Grants Management Project, the Grants Centre of Excellence has worked closely with colleagues in WEFO to ensure that the good practice being developed by the Grants Centre of Excellence is shared. This ensures that appropriate and consistent processes are built in to WEFO procedures and controls.

SECTION 3: GRANTS MANAGEMENT IMPROVEMENTS

3.0 This section details the improvements that have been made in grants management within the Welsh Government since the introduction of the Grants Management Project (GMP) and the establishment of the Grants Centre of Excellence, as part of the GMP. There are six key improvement areas that have been focused on:

- (i) support for Grant Officials;
- (ii) compliance;
- (iii) training;
- (iv) communication;
- (v) collaboration; and,
- (vi) IT system.

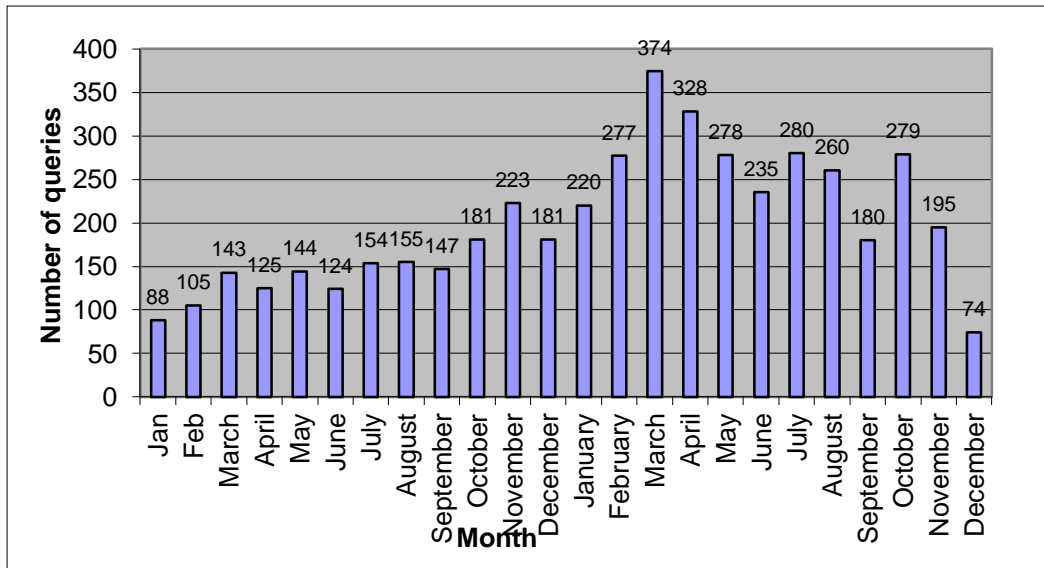
(i) Support for Grant Officials

3.1 The Grants Centre of Excellence currently consists of 10 expert personnel with an annual cost of £470k, however, as it moves into business-as-usual this will reduce to 5 experts with an annual cost of £187k. The support established by the Centre for grant officials includes developing processes, guidance and help to embed consistency in grant management, whilst ensuring proportionality.

Helpdesk

3.2 The Grants Centre of Excellence is the first point of contact for queries on whether a proposed activity should be funded through grant or procurement. Procurement matters are referred to the Welsh Government's Value Wales Division with all grant issues being handled by the Grants Centre of Excellence team. The support available from the Grants Centre of Excellence has been widely advertised, which has resulted in a significant number of requests for advice being received. Figure 11 shows the high number of monthly queries that have been responded to. Feedback from those using the Helpdesk suggests that this support is well received.

Figure 11: Queries handled by the Grants Centre of Excellence in 2012 and 2013



Source: Grants Centre of Excellence Queries Log

3.3 The Grants Centre of Excellence has recently become the first point of contact for any grant related concerns from external organisations. The Centre acts as a point of contact to provide advice and guidance or to direct the query to the appropriate department. An internal escalation process has also been implemented to ensure that issues and concerns are appropriately communicated and resolved.

Minimum Standards

3.4 At the inception of the Grants Centre of Excellence, a decision was made to review all current grants within the Welsh Government. The review is detailed later in this report (paragraph 3.14). In order to undertake the review of grants in a consistent way, minimum standards were developed against which grants could be assessed. The standards represent an agreed approach to grants management, which accommodate relevant law, policy and good practice. They provide a framework for the development, implementation and processing of any new grant and they are mandatory. These standards have subsequently been published and shared with WLGA, WCVA and the Cabinet Office for further dissemination.

Standard Award Letter Template

3.5 A standard award letter template was developed in 2012 to provide a level of consistency across grant funding agreements. The use of the template became mandatory for hypothecated grants from April 2013. Over 95% of award letters now utilise this template. The remaining 5% relate to complex and very low value grants, where the use of the template would be inappropriate.

3.6 The award letter template is only issued following a discussion between grant officials and the Grants Centre of Excellence. Furthermore, completed award letters

are also checked by the Centre in Welsh or English prior to issue to ensure accuracy, compliance and that proportionality has been considered.

3.7 The award letter template is reviewed annually with legal colleagues and any revisions made are notified to officials via the Welsh Government intranet. The template has also been shared with the Cabinet Office as an example of best practice which can be adapted to meet UK Government grant requirements.

Guidance

3.8 Overarching guidance has been developed which provides comprehensive advice on the various stages of a grant life cycle. The guidance includes templates and checklists which can be amended to meet individual grant requirements. It has recently been reviewed and updated and is available to officials on the grants intranet pages.

3.9 The standards and associated guidance require that a proportionate assessment of risk is undertaken for all external bodies receiving public funding. Proportionality and materiality must be considered at all times when assessing risk. Guidance on risk has been finalised and risk training will be provided for officials to ensure that appropriate processes are applied consistently.

Administration Costs

3.10 The Welsh Government has made a commitment to the PAC to reduce administration costs associated with grant funding, both for the Welsh Government and grant recipients. Since the PAC sessions in May 2012, the Welsh Government has consulted with the Big Lottery, WAO and the Cabinet Office as to the most appropriate way to measure and subsequently reduce administration costs.

3.11 The Welsh Government and UK Government departments are not solely focussed on the delivery of grants; this work is part of a much wider role relating to the development and implementation of policy. In the circumstances it is difficult to separate the cost of the development of policy, grants management processes and associated administration costs relating to grants. Consequently, the Cabinet Office has been unable to baseline administration costs for grants across UK Government departments in a consistent manner and the Welsh Government has similarly been unable to baseline for the reasons indicated above. Taking these points into account, the Welsh Government has adopted the following approach to reducing administration costs:

- increasing the duration of the grant. Grant recipients who are regularly funded can (where budgets allow) now apply for funding for a number of years, where previously they have needed to apply for funding annually. This approach reduces the administration costs for both the Welsh Government and the recipient, whilst giving the recipient increased certainty of funding;
- encouraging consortium working. The Welsh Government encourages consideration of collaborative working including whether an activity can be provided by a consortium rather than single organisations. Where adopted,

the approach reduces internal administration costs with award letters being issued to consortia leads only rather than individual organisations;

- combining grant schemes awards into one letter. Policy divisions are encouraged to issue one letter per organisation to cover a number of grant schemes rather than issue separate award letters;
- a commitment to move from hypothecated to unhypothecated grants for Local Authorities. The Welsh Government is committed to consider moving hypothecated grants into the main unhypothecated RSG wherever appropriate. This approach will ultimately reduce both internal and external administration costs.

3.12 The Grants Centre of Excellence has worked with numerous grant managers to implement these principles and their uptake will be recorded and their impact measured in order to demonstrate a reduction in administration costs.

Case Study – Guidance for Grant Officers

Wales European Collaboration Fund (WECF) grant programme

The WECF awards small grants of £1,000 to £10,000. A review of the programme, processes and administration documentation was undertaken.

Following advice and guidance provided by the Grants Centre of Excellence including consideration of proportionality, the separation of duties and using written guidance/templates, the programme has been changed and simplified in a number of ways:

- The nature of awards has been changed from repayable to non-repayable. The relatively small sums involved and the cost of processing/administration was likely to exceed the sums reclaimed;
- a standard assessment template was introduced. Proportionate due diligence checks replaced full detailed financial appraisal; and,
- a linked payment/monitoring process was introduced.

The guidance given and the reassurance on proportionality considerations, enabled the new administration team to simplify the programme and processes, resulting in a more efficient programme and subsequent administration cost savings for both applicants and the Welsh Government.

(ii) Compliance

3.13 Minimum standards have been developed and are mandatory. Compliance with these has been tested during the 2011/12 review of grants and subsequently via spot checks by the Grants Centre of Excellence.

Grants Review 2011/12

3.14 A review of all grant schemes was undertaken in 2011/12. The review process involved officials from every grant scheme completing a questionnaire, which was then assessed by the Grants Centre of Excellence against the minimum standards.

3.15 The review considered whether grant funding was the best mechanism for each of these schemes and advised if an alternative funding route, for example procurement or loan, was more appropriate. Where it was identified that the funding should have been provided via another mechanism it was recommended that the alternative should be used at the end of the current grant award period. Almost ten percent of the grants reviewed were advised to consider procurement as a more appropriate funding mechanism.

3.16 The Grants Centre of Excellence assessed each funding programme to determine whether it was compliant and met the minimum standards. Areas for improvement were identified where the funding programme did not comply or meet the necessary standards. An action plan was agreed with the relevant official to rectify any weaknesses within an appropriate timescale. Departmental reports were subsequently produced, initially providing details on the grants reviewed and the weaknesses identified, and subsequently detailing progress against the action plans. All of the action plans have been completed and all weaknesses identified have been rectified. New grant schemes are subject to the same level of assessment as that undertaken during the review.

Spot Checks

3.17 Spot checks have been implemented to ensure continued compliance with the minimum standards. These involve the random checking of grant scheme documentation (for example, an award letter or the application mechanism used) of selected Welsh Government schemes. Currently 15 grants are checked each month and this will rise to 20 per month by the end of 2013/14.

3.18 The Grants Centre of Excellence reviews selected documentation against the grants minimum standards. Feedback is provided within five working days; those who do not reach the minimum standards are provided with support to improve their processes. Where major concerns are raised, an in-depth review of the activities is undertaken; concerns identified are resolved through the internal escalation process.

(iii) Training

3.19 A training needs analysis was undertaken in June 2012 to inform the future training requirements of officials administering Welsh Government grants. A questionnaire was used to assess the need and demand for grants training. Overall, 47% of respondents had received training on e-Grants (Welsh Government's grants payment system) and just over 70% of respondents had not had any other formal grants training. The key learning method identified was on-the-job training delivered

by line managers/peers and the majority of respondents suggested that there was a need for additional, more formal grants training.

3.20 Initial training on key grant functions was provided electronically to maximise learning opportunities. This ensured that relevant officials were quickly appraised of key grants management activities. User understanding of the information conveyed was established through end-of-module tests. This initial computer based training will be expanded upon and learning consolidated through face-to-face training where specific grant functions are considered in more depth.

3.21 The e-Grants computer based training has been made mandatory for any official requiring access to the e-Grants system, with completion of the training being required before access is permitted.

3.22 Three computer based training modules have been developed and implemented:

- **Grants for Relevant Senior Officers:** aimed at officials who are responsible for the delivery of grant funding programmes. It provides a high level overview of the grants management processes, identifying key areas of relevance to senior managers. The module is mandatory for all officials who have overall responsibility for specific grant programmes (Relevant Senior Officers). The training was launched on the intranet in December 2012 and since then over 280 officials have successfully completed the training. In general the training has been very well received, with excellent feedback. It has significantly raised the profile of grants and the processes that must be adopted by senior officials of the Welsh Government.
- **e-Grants for Certifiers and Authorisers:** aimed at officials who utilise the e-Grants payment system. The e-Grants system is used to make the great majority of payments for grants. Previously all officials in the Welsh Government were provided with certifier access to the e-Grants system, which enabled them to enter claims for grants payments. However, authoriser status was only provided to those officials who had delegated authority to approve grant payments.

A number of changes have been made to the e-Grants system to improve its reporting capability. Training was therefore developed to minimise inconsistencies in the use of the e-Grants system which could ultimately impact on the accuracy of reports. The training was released on the intranet to all officials in March 2013. To date over 1,100 officials have successfully undertaken this training. Any official requiring certifier or authoriser access on e-Grants is required to pass this training first.

- **Grants for Grant Managers:** is aimed at officials who are responsible for the day-to-day management of grants (Grant Managers). The training consists of three modules and is mandatory for all Grant Managers and optional for all other officials. The level of detail included in this training is much greater than in the overview provided in the

Relevant Senior Officers training. An 80% pass rate is required for each module and officials who successfully complete all 3 modules are given certified status.

This training was released in June 2013. Over 480 grant managers have successfully undertaken the training. This has given a proportion of grant managers confidence that they are undertaking the correct processes whilst others have asked the Grants Centre of Excellence for further support in improving their processes.

Other Training

3.23 A programme of training on Structural Funds for project sponsors and for internal staff is being run by WEFO in anticipation of the new round of funding programmes. This covers the content of the new programmes, changes to the way projects are selected and changes to the management and control of projects under the regulations for the next round of funding.

3.24 The WLGA is developing a range of training programmes for Local Authorities via the Chartered Institute of Public Finance and Accountancy (CIPFA). The training will be delivered to Local Authorities in a number of ways including regional events and themed sessions in early 2014. The Welsh Government will support the development of the training to ensure that Welsh Government processes, procedures and policies are given due consideration.

(iv) Communication

Internal Communication

3.25 The Welsh Government recognises that internal communication between its departments has sometimes been uncoordinated both in terms of sharing corporate intelligence and best practice. The establishment of the Grants Centre of Excellence has resulted in it becoming standard practice for the Centre to engage with officials to maximise information sharing within and across departments. In a recent letter to grant managers throughout the Welsh Government, the Permanent Secretary highlighted the need for grants to be managed in a compliant and consistent manner with officials taking due responsibility for funding provided via grants.

Grants Awareness Sessions

3.26 The Grants Centre of Excellence arranged and hosted a programme of awareness sessions about grants management across Wales in March 2013. The sessions were aimed primarily at officials dealing with grants and highlighted the changes being implemented to grants management explaining why they had been introduced, what was expected of officials to bring about the improvements and provided an opportunity to share best practice and any concerns. All sessions were introduced by senior managers and included a video message from the Permanent Secretary on the importance of grants management and compliance.

3.27 Originally seven sessions were scheduled, however, due to high demand; an additional three sessions were arranged. They were held at seven different locations in Wales, hosting a total of 245 attendees. Over 93% of attendees rated the sessions as either excellent or good.

3.28 A second series of sessions was held across Wales in November 2013. The sessions were aimed at all officials working on grants and were a follow-up to the awareness sessions held earlier in the year. Their aim was to highlight the importance of good grants management and the potential impact if this was not undertaken.

3.29 Sessions were once again hosted by the Head of the Grants Centre of Excellence and introduced by a senior manager. The focus of each session was a case study exercise where attendees were asked to discuss and identify errors in grants processes, identify what should have been done differently and what the potential implications would be for the Welsh Government. The importance of carrying out grant processes properly was reiterated by informing attendees of real life instances where errors, similar to those in the case studies, had been made and resulted in financial loss and reputational damage for the Welsh Government.

3.30 Each session also included the key information that grant managers need to be aware of, a section on the due diligence pages to highlight the importance of sharing information across the Welsh Government, as well as an opportunity for attendees to ask questions. Twelve sessions were held over nine different locations in Wales, with a total of 368 staff attending the sessions.

3.31 The feedback was positive and demonstrated that attendees found these sessions beneficial. The group case study exercise was particularly well received as attendees felt it was an effective way of underlining the importance of carrying out grant processes correctly and the severity of the consequences if processes are not followed.

External Communication

3.32 The role of the Grants Centre of Excellence has evolved from purely an internal facing team to being both internal and external facing. As the focus has changed, the Centre is now advertised as the primary contact on the Wales.gov.uk website, should there be any query or concern with the administration of a grant or grant scheme.

3.33 The Grants Centre of Excellence has actively engaged with funding recipients to publicise its role as the single point of contact for advice on applications for funding. This enhanced engagement has included revising and improving the Welsh Government's public website pages on grant funding.

(v) Collaboration

3.34 The Welsh Government is the principal provider of grant funding in Wales. As such it is well placed to share intelligence with other funding providers about any organisation it has grant funded. Where either tangible or intangible concerns arise

regarding an organisation or an individual, which could have an impact on external organisations that also provide grant funding, then information will be shared. For example, with relevant partner bodies such as the WCVA, WLGA to enable them to make an informed decision on the risks associated with their funding of organisations.

3.35 This existing informal process will provide the basis for the development and agreement of formal terms of engagement, which are currently under discussion at a Good Governance Group and which are due to be agreed by the end of 2013/14.

3.36 The Welsh Government is working collaboratively to implement the PAC's recommendations and improve grant practices more widely. It has engaged with the WAO, WCVA and WLGA on a range of policy and practice issues including the development of comprehensive guidance for Local Authorities on the different funding allocation methods available. Engagement with these organisations will continue to support them with their grants management improvement activities.

(vi) IT system

3.37 The Welsh Government has acknowledged the limitations of its existing overall management information and corporate data available to support decision making on grants. The systems used to process grant payments already interface with the Welsh Government finance system, however, there is limited visibility of data between systems and across the Welsh Government. This has led to the development of local systems to provide added assurance and for reporting purposes.

3.38 These issues were highlighted in the November 2011 WAO report, Grants Management in Wales, which recommended that funders should develop systems that ensure that the approach taken to grant funding and the operation of grant schemes is as consistent as possible across internal departments. This was further underlined through the PAC inquiry into Grants Management in Wales. The final report published in June 2013 recommended that "Welsh Government sets out timescales for the introduction of a central grants management IT system".

3.39 The Welsh Government accepts that the introduction of a comprehensive, central grants management IT system would help provide management data to inform decisions on grant funding. Work is therefore underway to give due consideration to identifying the optimum solution and how it should be implemented. A business case has been prepared and a decision is expected on this shortly.

3.40 Whilst a decision is awaited on the central grants IT solution, some tactical enhancements to the existing e-Grants system have been implemented to provide better management information across the Welsh Government. These are:

- **New Summary Reports:** provide a wide view of all active grants schemes. They give a better understanding of the value and volume of grant offers and payments made across the Welsh Government, comparing recent history with current year activity.

- **Due Diligence:** a new corporate information sharing area has been developed and implemented on the Welsh Government finance portal. This facilitates the sharing of information about an organisation and provides a point of contact for officials seeking further details. Links are also made to the Welsh Government's finance system to highlight any organisations/individuals that have been blocked for payments. The facility prompts officials to seek further information before awarding a grant or processing a claim.

SECTION 4 – NEXT STEPS FOR GRANTS MANAGEMENT

4.1 The Welsh Government is committed to making its grants management processes as efficient and effective as possible. Whilst significant progress has been made, work is continuing to embed these fully across the organisation so as to ensure that any risks associated with this work are managed to a minimum.

4.2 The following activities are planned to develop grant management arrangements over the next 12 months:

- **enhanced information on Grant Personnel in e-Grants** - key officials responsible for each grant scheme will be identified and the grant scheme set-up process will be amended to hold this information;
- **improved financial information from e-Grants** - a new method of simplifying the selection of the appropriate finance code is being developed, which will reduce the risk of miscoding;
- **grants training** - comprehensive training on key aspects of grants administration will be delivered across Wales;
- **compliance with minimum standards** - to be further encouraged and measured through responses to queries and spot checks;
- **communication exercises** - new awareness sessions and intranet articles to communicate changes and best practice;
- **measuring reductions in administration costs** - changes to grants programmes that result in reduction of administration costs will be recorded and their impacts measured;
- **decision reached on establishing a central grants management IT system.**

4.3 The changes to the e-Grants system together with training and communication activities will ensure that officials are better informed of the processes they need to undertake to improve grants management. This, together with the necessary enforcement activities undertaken by the Grants Centre of Excellence, will help to embed further improvements in grants management across the Welsh Government. Progress against these activities will be reported in the next Annual Grants Management Report.

SECTION 5 – KEY THEMES IN THE WAO AND PAC REPORTS

5.0 The three reports on grants management in Wales² made specific recommendations on how to improve the way the Welsh Government manages grants in Wales. This section of the annual report provides a brief summary of the actions taken in response to the key themes from the WAO and PAC reports. The specific recommendations, responses and progress are included in the Annexes to this report. In total, 41 recommendations were made. The latest position is that action has now been completed for 37 of these and work on the remaining recommendations is ongoing.

Review of All Grant Schemes Administered by the Welsh Government

5.1 All grants in existence in the year 2011/2012 were reviewed by the Grants Centre of Excellence against minimum standards. The reviews took approximately one year to complete and resulted in identification of best practice and action plans where weaknesses were identified. Guidance for grant managers and the minimum standards have been revised to incorporate best practice identified in this review. Where weaknesses were identified, the Grants Centre of Excellence has monitored and reviewed the associated action plans and ensured that weaknesses have been rectified.

5.2 All new grant schemes introduced since the review have been subject to a robust vetting process, which includes consideration of whether a funding intervention is required and, where it is, whether grant funding is the most appropriate vehicle for that purpose.

Local Authorities

5.3 The WAO report in November 2011 focussed on grants management across the public sector and not purely on the management of grants by Welsh Government. Local Authorities were criticised for their management of grants and the number of audit qualifications entered against claims to the Welsh Government. The Welsh Government has worked closely with the WLGA to resolve the issues identified in the reports.

5.4 Welsh Government is working in conjunction with the WAO and the WLGA with regard to training and sharing of expertise relating to funding mechanisms and minimum standards and is in discussions with CIPFA concerning the provision of training on grants management to the wider public sector in Wales. The latter will help reduce the number of qualifications from the WAO in relation to the auditing of grant claims. The Welsh Government is committed to assisting the WLGA in reducing the frequency of such qualifications.

² WAO Report – Grants Management in Wales– November 2011, PAC Interim Report – Grants Management in Wales –August 2012, PAC Final Report – Grants Management in Wales –June 2013

Grants Management Improvements

5.5 The Welsh Government continues to consider best practice from around the UK and seeks, via its Grants Management Project, to provide the best value for the Welsh pound. One of the issues specific to this is the reduction of administration costs. Whilst it has proven impossible to baseline the costs incurred due to a variety of reasons, the overall cost of grants administration is expected to fall due to initiatives aimed at the amalgamation of schemes and the transfer of Local Authority hypothecated schemes into unhypothecated RSG.

5.6 The introduction of the standard Award Letter template has ensured that a uniform approach has been provided across the Welsh Government. The use of this template has taken forward cultural change with emphasis being placed on grants delivering policy objectives; the template specifically states what will be achieved.

5.7 With the establishment of the Grants Centre of Excellence, the Welsh Government has established a first point of contact for advice on funding applications. Should grant funding be the required route, then appropriate advice is given by the Grants Centre of Excellence however, should the funding be better suited to procurement, then the matter is passed onto Value Wales.

5.8 The Welsh Government has worked closely with, and will continue to engage with, the grants project in the Cabinet Office. This has included the sharing of best practice and training modules developed by the Grants Centre of Excellence.

Third Sector

5.9 The Welsh Government appreciates that the Third Sector makes a substantial contribution to providing services to the people of Wales. As funding to the Third Sector is essential to the delivery of key policies, the Welsh Government accepts that specific considerations must be made due to the nature of the sector. The Welsh Government has recently undertaken a consultation on the Code of Practice for the Third Sector and how it interacts with the sector. Although this consultation has been completed, the revised Third Sector Scheme and Code of Practice will not be issued until early 2014. The revised Code of Practice will require the Welsh Government to be more proactive in monitoring its compliance with the Code.

5.10 The Welsh Government remains committed to working with the Third Sector Partnership Council and has developed the Payment in Advance template in conjunction with its Funding and Compliance sub-committee. The Payment in Advance template allows Third Sector organisations to demonstrate the need for payment in advance in a consistent manner. The Welsh Government will monitor any concerns relating to the Payment in Advance template and any non-compliance with the Code of Practice.

Training and Compliance

5.11 The Grants Management Project was introduced to improve the standard of grants management. As a consequence, the project has developed and implemented detailed processes and procedures across the Welsh Government.

These developments have been supported by a host of communication activities, development of minimum standards, training for grants officials and spot checks to ensure compliance.

5.12 Going forward, the Grants Centre of Excellence will concentrate on the delivery of very specific face-to-face training and focussed working with grant managers to ensure the required cultural changes are made. This will ultimately ensure improved grants management through the embedding and implementation of minimum standards in a compliant and consistent manner.

Collaborative Working

5.13 The Welsh Government recognises that it is not the only grant funder in Wales. Working with other funders and organisations can bring significant benefits to both the Welsh Government and funded organisations. Since the publication of the WAO and PAC reports, the Welsh Government has engaged with a number of funding organisations including WCVA, WLGA, Arts Council of Wales and Big Lottery. This collaborative working has resulted in the agreement to prepare terms of reference for information sharing.

Management Information and Reporting

5.14 The Grants Management Project has made significant improvements to the e-Grants payment system, which has enabled improved reporting and increased consistency across the Welsh Government. Additional enhancements will be undertaken before the end of the 2013/14 financial year which will further improve the reporting capability of the system. The Welsh Government is currently considering possible next steps in establishing a definitive source of information on grants management.

ANNEX 1

WAO Report - Grants Management in Wales – Recommendations and Progress - November 2011

Recommendation 1

We recommend that funders should look to simplify their grants portfolio more rapidly, by combining schemes where this is appropriate, in order to realise efficiencies in administration cost and in the hidden costs to the public purse borne by unsuccessful applicants.

Progress

This is an ongoing and continual process. The Welsh Government has simplified its grants portfolio by significantly reducing the number of grant schemes and offers of grant made. Over the last three financial years schemes have been reduced by 16% and offers by 14%.

Status

Ongoing.

Recommendation 2

We recommend that funders should develop systems to ensure that the approach taken to grant funding and the operation of grant schemes is as consistent as possible across internal departments and, where possible, with other funders.

Progress

The Welsh Government has taken steps to improve the consistency across its departments by introducing minimum standards for all grants' processes. The approach has been shared with other key funders including WCVA, WLGA to help improve consistency of grants management across Wales. Mandatory training for Welsh Government staff administering grants has been introduced and was fully rolled out in June 2013. This will be supplemented by more detailed training, which will be rolled out from January 2014. The training modules will also be shared as appropriate with other key organisations offering funding as it is developed during 2014.

Status

Complete.

Recommendation 3

We recommend that funders should work with other funders to learn from experience, develop complementary schemes and co-ordinate bidding timetables.

Progress

A Good Governance Group has been established with WAO, WCVA, WLGA, Big Lottery and the Charity Commission, to help facilitate learning and provide a focus for good practice.

Status

Complete

Recommendation 4

We recommend that funders should work singly and together to improve the clarity and accessibility of grant related information to bidders and encourage appropriate community involvement.

Progress

The Welsh Government has an active programme of work to help improve the clarity and accessibility of grant information for bidders. It has redesigned its internet pages on grants to provide greater clarity. Through the refreshed Third Sector Scheme and Code of Practice the Welsh Government is seeking to encourage increased community involvement. Following the recent consultation on the Welsh Government's relationship with the Third Sector, work is continuing to revitalise the Third Sector Partnership Council and increase awareness of its activities. The Minister for Finance also holds regular meetings with Third Sector representatives, at which community involvement and benefits feature prominently in discussions.

Status

Complete.

Recommendation 5

We recommend that funders should ensure that risks relating to bidders' viability capacity and capability are considered at the bidding stage, mitigated by additional support where this would be cost effective and monitored carefully during project delivery.

Progress

The Welsh Government has set minimum standards of initial and ongoing due diligence to be undertaken for all grants. It has also developed a due diligence IT system that enables the sharing of corporate information across all departments. A requirement for the regular monitoring of projects has been established and this will follow the conditions detailed in a new standard award letter.

Status

Complete.

Recommendation 6

We recommend that funders should ensure that project outcomes and standards of project and financial management are clearly defined and agreed in writing with recipients before releasing funds.

Progress

The Welsh Government's new standard award letter template for grants ensures that specific outcomes, targets and requirements are included within all award letters. The grant recipient must accept the terms and conditions prior to any payment being made, thus making the terms of the grant clear to all parties.

Status

Complete.

Recommendation 7

We recommend that funders should consider the relative merits of approaches other than grant funding, such as procurement, loans and investments, before committing to a new or continued grant scheme as the most appropriate mechanism for achieving the stated objectives.

Progress

The Welsh Government's Grants Centre of Excellence reviews all new grant scheme proposals. As part of this review, consideration is given to the type of funding proposed and alternatives to grant will be recommended where these are considered more appropriate.

Status

Complete.

Recommendation 8

We recommend that funders should take robust action when grants have been overpaid or misused, by suspending funding where necessary, recovering appropriate sums and, where funding is continued, strengthening requirements on recipients and monitoring arrangements before releasing further funding.

Progress

The Welsh Government has learnt lessons from the All Wales Ethnic Minority Association (AWEMA) and other situations and new and significantly more robust grant management arrangements have been established. These include taking appropriate action such as the suspension of payments, where a breach of grant conditions is identified.

Status

Complete

ANNEX 2

PAC – Grants Management in Wales - Interim Report – Recommendations and Progress - August 2012

The Welsh Government accepted all of the recommendations made in this report.

Recommendation 1

We recommend that the Welsh Government ensures that all grants have been reviewed as part of the Grants Management Programme, to ensure that they are the most effective means of delivering Ministerial objectives by 31 December 2013.

Latest Progress

All the grants provided by the Welsh Government for the 2011/2012 financial year have been reviewed and a final report on compliance and findings has been issued to senior management. All new grants are now approved by the Grants Centre of Excellence before entry onto the grants payment system.

Status

Complete.

Recommendation 2

We recommend that the Welsh Government considers the wide spectrum of funding options when reviewing the effectiveness of existing grants.

Latest Progress

In the review of 2011/2012 grants, part of the process included an assessment of whether alternative funding mechanisms were suitable. Appropriate action was recommended and implemented as required. All new grant scheme proposals are reviewed by the Grants Centre of Excellence and, where it is considered that an alternative funding mechanism should be used, appropriate action is taken. Alternative funding mechanisms include loans, procurement and repayable grant funding.

Status

Complete

Recommendation 3

We recommend that the Welsh Government should provide guidance to Local Authorities, to ensure they consider this wide spectrum of funding mechanisms (including grants and collaborative commissioning) for procuring the delivery of desired outcomes.

Latest Progress

The Welsh Government has shared its grants guidance with the WLGA which is encouraging its wider adoption by local government in Wales.

The WLGA is working with the WAO on its good practice events and other public service partners such as the WCVA on the appropriateness of grant funding compared with other mechanisms. The WLGA has commissioned CIPFA to design

and deliver a programme of training on grants administration and management. The programme will comprise of a comprehensive series of modules which are aligned to roles and functions within a local authority's operation of a full grants process. The training will be delivered through a series of regional workshops across Wales complemented with specific 1:1 organisation training where appropriate. The training will be open to include organisations outside the local authority in receipt of grants, helping to build understanding and improvements in the whole process. The training will be developed and delivered in March 2014.

Status

Complete.

Recommendation 4

We recommend that the Welsh Government considers good practice elsewhere in the UK in addressing practical challenges over the transfer of specific grants into the general revenue support settlement.

Latest Progress

Specific enquiries to the Scottish Government have concluded that the Welsh Government's existing approach of addressing the transfer issues through the partnership arrangements are consistent with the approach in Scotland.

The Welsh Government's Reform Policy Steering Group (RPSG) commissioned an exercise in autumn 2012 to review the exit strategies for all hypothecated grants. The information gathered from the exercise commissioned by RPSG was used to brief the Minister for Local Government and Government Business on the position on specific grants and to inform Ministers' discussion on the 2014-15 Budget and Local Government Settlement. The Local Government Settlement for 2014-15 reflected a transfer of £40 million of funding previously provided as specific grants into the settlement. A further review of funding flexibilities in partnership with Local Government has also been announced.

Status

Complete.

Recommendation 5

We recommend that the Welsh Government should adopt a target of no more than 5% of its overall grant funding going towards administration of grants.

Latest Progress

The Welsh Government will reduce administration costs through a number of activities including collaborative working (both internally and externally), increasing the duration of grants and transferring hypothecated grants for Local Authorities into the unhypothecated RSG (see paragraphs 3.10 to 3.12).

The Grants Centre of Excellence will measure the impact of these activities and the associated reduction in administration costs and will report progress in the next annual report on grants management.

Status

Complete.

Recommendation 6

We recommend that the Welsh Government ensures that managers make timely decisions on continuing or ending grant funding, and must abide by its Code of Practice for funding the third Sector.

Latest Progress

The Code of Practice for Funding the Third Sector has been fully revised in collaboration with a wide range of stakeholders. This process has been overseen by the Funding and Compliance Sub Committee of the TSPC. The revised Code, which will now be formally annexed to the revised Third Sector Scheme, reinforces the need for timely decisions and states clearly that the Welsh Government will be proactive in ensuring that Grant Managers comply with this requirement.

The Welsh Government has put processes and procedures in place to check and monitor compliance with the Code of Practice. Any non-compliance will be reported to the Funding and Compliance Sub-Committee of the TSPC and recorded in the Welsh Government's Annual Report on Grants Management.

The need for compliance with the Code of Practice will be reinforced in the face-to-face training on funding the Third Sector which is currently being developed by the Grants Centre of Excellence.

Status

Complete.

Recommendation 7

We recommend that the Welsh Government publish an annual grants management report. This should include progress towards its target for administration costs and details of any non-compliance with its Code of Practice for funding the third Sector.

Latest Progress

First annual report published.

Status

Complete

Recommendation 8

We recommend that the Welsh Government develops a transparent, proportionate and consistent business test for determining whether to make advance payments of grants to organisations.

Latest Progress

A template for determining the need for payment in advance has been developed in conjunction with the Funding and Compliance Sub-Committee of the TSPC. This template is used by all grants schemes within the Welsh Government that provide funding to the Third Sector. Payment in advance is only made where the need for this has been demonstrated and validated.

Status

Complete

Recommendation 9

We recommend that the Welsh Government accelerates its development of a range of standardised terms and conditions to particular types of procurement processes.

Latest Progress

The Welsh Government has developed and implemented standard terms and conditions for both grant funding and procurement.

Status

Complete.

Recommendation 10

We recommend that the Welsh Government establishes a single-point of contact for advice on funding applications (including, but not limited to, grants).

Latest Progress

The Grants Centre of Excellence has been established as a single point of contact for advice on funding applications (including grants) both internally and externally. Direct public access to the Centre is available through the Welsh Government's redesigned internet pages on grants.

Status

Complete.

Recommendation 11

We recommend that the Welsh Government holds to account Local Authorities which have had high rates of grants claims being qualified or adjusted. As part of this, the Welsh Government might consider withholding funding from Local Authorities if the frequency of qualifications on grant claims does not improve.

Latest Progress

The Welsh Government has tracked the incidence of qualified or adjusted grant claims within local authorities. The Welsh Government has reviewed its grant certification requirements and instructions in order to ensure that they remain appropriate. A revised audit certification format has been developed in conjunction with the WAO, which has made non-compliance more obvious.

The WAO has given a training session to Welsh Government officials on the importance of audit certification and processes involved. Over 30 officials attended the session. The training included the relevance of qualifications and the action required by the Welsh Government when qualifications appear on audit certificates.

The Welsh Government has worked closely with the WLGA in order to achieve a reduction in the frequency of qualified grant claims. The WLGA has also identified good practice and has developed an internet page on grants, which further promotes best practice and signposts the support and help available to practitioners.

The WLGA is working with CIPFA to develop and deliver suitable training on grants management for local government officers.

Status

Complete.

Recommendation 12

We recommend that the Welsh Government engages in dialogue with the WLGA towards enabling a reduction in the frequency of grant claims by Local Authorities being qualified. This should include the WLGA:

- actively sharing best practice;
- supporting poorly performing authorities; and
- ensuring that those authorities (particularly the quartile of authorities with the highest rates of qualified grant claims and returns) do not lead on regional grant claims.

Latest Progress

Response combined with Recommendation 11. See progress detailed above.

Status

Complete.

Recommendation 13

We recommend that, taking into account the need for proportionality and proper procurement processes, the Welsh Government should include in its terms and conditions for grants and other forms of funding, a requirement that recipient organisations participate in the National Fraud Initiative.

Latest Progress

The Welsh Government's standard award letter template has been revised to include the requirement for grant recipients to participate in the National Fraud Initiative (NFI) or other counter fraud activities when invited to do so. The Welsh Government continues to work closely with the WAO to increase the range of publicly funded bodies which are included within the NFI. Recent discussions have considered the scope of involving Welsh Government sponsored bodies and the further and higher education institutions.

Status

Complete.

Recommendation 14

We recommend that the Welsh Government enables the ongoing provision of accredited training for grants managers. As part of this, we recommend that the Welsh Government monitors the effectiveness with which such training will be put into practice by grants managers.

Latest Progress

The Welsh Government has established and provided a wide range of training modules for Grant Managers, including computer based training and face-to-face training activities. E-learning modules have been developed for senior staff and grant managers on grant processes and procedures, and for users of the grants IT system regarding the importance of correct and compliant use. Over 2000 staff received grants training as a result. The Grants Centre of Excellence has now started delivering face-to-face training across six offices in Wales to expand and develop information contained in the e-learning modules. Training delivery on Application Forms, Monitoring, and Evaluation started in January 2014. Demand for the training has been very good; for the first tranche of training, 18 of the 25 events programmed exceeded capacity requiring additional modules to be arranged. Development of face-to-face modules on Working with the Third Sector, Minimum Standards, Risk Assessments and Funding Agreements are under development delivery for which will start in March 2014.

The effectiveness and completion rate of each module is being monitored closely to help assess any requirement for future improvements to the training.

Status

Complete.

Recommendation 15

We recommend that the Welsh Government ensures that funding provided by its grants is used to support outcomes consistent with its strategic policy objectives.

Latest Progress

The Welsh Government's standard award letter template requires outputs and outcomes to be clearly defined at the approval stage and included in schedules of the letter. These deliverables require monitoring throughout the duration of the grant and grant managers are required to evaluate the effectiveness of the funding against policy objectives at both the individual funding and the grant programme levels.

Status

Complete.

ANNEX 3

PAC – Grants Management in Wales – Final Report – Recommendations and Progress – June 2013

The Welsh Government accepted all of the recommendations made in this report.

Recommendation 1

We recommend that the Welsh Government publicly sets out in an annual grants report:

- how individual grants were reviewed in its Grants Management Review;
- which alternative funding options were considered;
- what rationale was used to determine the most effective funding options in each case;
- how it will continue to monitor the progress of each Department in implementing the recommendations of its review; and
- how it evaluates the effectiveness of external organisations (whether they are an umbrella body representing a sector, or distributing funds as the lead sponsor of a project) in managing the distribution of funds to other organisations

Latest Progress

This annual report includes all of the key information recommended by the PAC.

Status

Complete.

Recommendation 2

We recommend that the Welsh Government engages in dialogue with the Wales Audit Office, WCVA and WLGA in its development of clear guidance for Local Authorities, to ensure that they consider a wide spectrum of funding mechanisms (including grants and collaborative commissioning) for procuring the delivery of desired outcomes.

Latest Progress

The Welsh Government is working in conjunction with the WLGA with regard to training and sharing of experience relating to funding mechanisms and minimum standards. It has provided minimum standards and guidance to WLGA to take this recommendation forward and enable it to disseminate good practice. The WLGA website provides guidance on different funding allocation methods and the revised

Code of Practice for Funding the Third Sector in Wales includes a new section on commissioning and models of funding as well as advice for officials and potential applicants of funding.

Status

Complete.

Recommendation 3

We recommend that the Welsh Government proactively investigates whether there have been breaches in the Code of Practice for funding the Third Sector, and details such instances in its annual grants management report. We expect that the Welsh Government would publish its first such annual report by December 2013 at the latest.

Latest Progress

The Welsh Government has strengthened processes and procedures to access and monitor compliance with the Code of Practice which include spot checks of grant processes and proactive involvement with the development of grants to the Third Sector. Future progress with this activity will be included in future annual reports.

Status

Complete.

Recommendation 4

We recommend that the Welsh Government ensures that any problems associated with its payment-in-advance-template are reported in its annual grant report and also to the Funding and Compliance Committee.

Latest Progress

An update on the use of the Payment in Advance template is included in this annual report, however, the position remains as previously reported with no issues concerning its use having been reported to the Welsh Government.

Status

Complete.

Recommendation 5

We recommend that the Welsh Government takes action to enhance and publicise the role of the Grants Centre of Excellence as a single point of contact for advice on applications for funding. We expect this to include development of its public website.

Latest Progress

The Welsh Government has continued to enhance and publicise the role of the Grants Centre of Excellence both internally and externally. It has actively engaged with funding recipients to publicise its role as the single point of contact for advice on applications for funding. This enhanced engagement has included revising and improving the Welsh Government's public website pages on grant funding. The revised pages were launched in late 2013 and can be found at:

<http://wales.gov.uk/funding/grants/?lang=en>

Status

Complete.

Recommendation 6

We recommend that the Welsh Government sets out timescales for the introduction of a central grants management IT system, and the implementation of a Customer Relationship Management system.

Latest Progress

An options appraisal has been completed, which recommended SAP Grantor as the preferred solution. In order to deliver the full range of requirements this software will need to be implemented within the wider Welsh Government finance and procurement SAP solution. A business case for the development is in place and an investment decision including the timetable will be made in the first quarter of 2014. In the meantime, short-term enhancements to the existing e-Grants payment system are being undertaken.

In addition, functionality to share due diligence has been developed and released using the current systems and the coverage of management information for grants is being improved with the transfer of more of Welsh Government grant schemes onto the e-Grants system in the period leading up to the end of the financial year.

Status

Action instigated and ongoing.

Recommendation 7

We recommend that the Welsh Government details in its annual grants management report an update on its progress in:

- implementing the recommendations of this report, our interim report and the Wales Audit Office's Grants Management 2011 report.
- changing its cultural approach to managing grants, to ensure that the Welsh Government acts as a single organisation in its relationships with external recipients of public funding.

Latest Progress

An update on Welsh Government's progress in responding to the recommendations is contained in this report.

Status

Complete.

Recommendation 8

We recommend that the Welsh Government makes progress toward concluding its dialogue with the Big Lottery Fund, Charity Commission, WCVA and other appropriate bodies to develop, produce and implement terms of engagement for contact between different providers of publicly funded grants.

Latest Progress

Draft terms of engagement have been developed, discussed by the Good Governance Group and will be finalised in early 2014. This work is on schedule for completion by April 2014.

Status

Ongoing.

Recommendation 9

We recommend that in conjunction with its development of a customer relationship management system the Welsh Government develops a clear, proportionate framework with which to determine the risks involved in providing public funding to individual external bodies.

Latest Progress

Minimum standards for grants management are in place, which emphasise the need for proportionality. These minimum standards include the need to assess risk. Guidance on risk has been developed and issued to officials and risk training is being developed for roll-out in early 2014.

Status

Ongoing.

Recommendation 10

We recommend that the Welsh Government develops a mechanism for escalating its monitoring arrangements, in response to specific concerns arising around financial irregularities or governance issues, including when an organisation is given the benefit of the doubt.

Latest Progress

The Welsh Government has developed guidance. This includes the need for accurate and appropriate record keeping, coupled with monitoring processes that are suited to the situation which has given cause for concern. The new due diligence process, which was introduced in October 2013, also enables efficient sharing of information about external bodies.

Occasionally the Welsh Government identifies, or is notified of, tangible concerns regarding an organisation or individual. Where this could impact on other external organisations that provide grant funding, then the information will be shared with relevant partner bodies, e.g. WCVA, WLGA.

Ongoing spot checks will ensure departments' compliance with guidance and procedures. Any concerns identified through the process are resolved through the internal escalation process managed by the Grants Centre of Excellence.

Status

Complete.

Recommendation 11

We recommend that, as a condition of a grant award, the Welsh Government requires all recipients of grant funding to notify the Welsh Government of any

significant changes in their trustees (for example the resignation of a Chair or a third or more of trustees), a significant lapse of constitutionally required meetings, or a resignation of external auditors, with a proportionate explanation for such changes.

Latest Progress

The Welsh Government has developed guidance to help officials understand what action to take when they are notified of changes in trustees of funded bodies.

Status

Complete.

Recommendation 12

We recommend that the Welsh Government proportionately considers the implications of potential warning signs in grants management - such as significant changes in an organisations' trustees, a lapse in constitutionally required meetings or a resignation of external auditors - gathering further information as required (for example, using exit interviews).

Latest Progress

As for Recommendation 11 above, the changes to the Notification Events Schedule within the standard award letter template enables the Welsh Government to investigate matters which come to its attention and, if appropriate, to terminate grant funding. Likewise the guidance mentioned above covers these eventualities.

Status

Complete.

Recommendation 13

We recommend that, as a condition of a grant award, the Welsh Government requires all recipients of grant funding to notify the Welsh Government of any instances where there is a breach of that organisation's governing document regarding meetings of trustees, with a proportionate explanation for such.

Progress

As covered by the response to Recommendation 11.

Status

Complete.

Recommendation 14

We recommend that the Welsh Government includes in its requirements of external funding (including grant funding), detail on the proportionate accountability and responsibility of trustees. We expect this to include detail on:

- the particular circumstances in which a concern about an organisation's governance should be brought to the Welsh Government's attention;
- the appropriate mechanism for expressing concern about an organisation's governance to the Welsh Government.

Latest Progress

Welsh Government has produced information on the standard award letter template, which has been included on the grant funding pages of its public website. This sets out the responsibilities of Welsh Government and of funded bodies and refers to the circumstances and mechanisms for raising concerns about an organisation's use of public money and its governance arrangements.

The Welsh Government guidance now describes the scenarios which would typically result in a formal notification as explained in the previous response.

Status

Complete.

Recommendation 15

We recommend that the Welsh Government recognise that while using an umbrella body can offer benefits, any aspect of poor-management in one of them will lead to increased risks and potentially serious repercussions for other organisations that rely on support (financial or otherwise) from these organisations. When using an umbrella body the Welsh Government should clearly and publicly state the rationale for using it.

Latest Progress

In an oral statement on 12 November 2013, the Minister for Communities and Tackling Poverty set out proposals arising from the recent consultation. He reaffirmed Welsh Government support for an integrated Third Sector infrastructure in Wales, including WCVA, County Voluntary Councils (CVCs) and Volunteer Centres but proposed that a regional dimension should be introduced to their work during 2014. These proposals are now being taken forward through discussion with the TSPC and the infrastructure bodies themselves. This work will include further consideration of the relationship between the infrastructure bodies and more specialist umbrella bodies. An internal, cross-departmental group has also been formed within Welsh Government to keep Third Sector issues under review and ensure that the relationship between infrastructure and umbrella bodies is understood more widely.

Status

Complete.

Recommendation 16

We recommend that the Welsh Government evaluate the effectiveness of the training it has introduced for Grant Managers.

Latest Progress

The effectiveness of the training provided to grant managers through the Grants Centre of Excellence training modules has been, and will continue to be, evaluated. Further detail on progress is provided in this report (paragraphs 3.19 to 3.24).

Status

Complete.

Recommendation 17

We recommend that as a system of good practice, the Welsh Government should give serious consideration to disclosing the narrative of a report to external parties, so that it can be checked for factual accuracies, should it be required to undertake a similar review.

Latest Progress

Appropriate processes have been implemented to ensure compliance with this recommendation with the narrative of draft reports now being shared.

Status

Complete.

Recommendation 18

We recommend that the Welsh Government clearly and explicitly articulates its rationale for termination of, or a substantial cut in, funding to any organisation which has a grant, prior to that organisation's funding being terminated (or substantially cut). We anticipate that this rationale would normally only be provided to the organisation concerned.

Latest Progress

Appropriate processes have been implemented to ensure compliance with this recommendation.

Status

Complete.

Cyfarwyddwr Cyffredinol, Cyllid a Gwasanaethau Corfforaethol

Director General, Finance and Corporate Services



Llywodraeth Cymru
Welsh Government

Mr Darren Millar, AM
Chair – Public Accounts Committee

2 June 2014

Dear Mr Millar

Report of the Auditor General for Wales – European Union Structural Funds 2007-2013

I am writing in response to your letter of 7 May about the Public Accounts Committee consideration of the Auditor General for Wales' report on the European Union Structural Funds 2007-2013 (published 24 April 2014). The Committee requested a response from the Welsh Government to the Wales Audit Office (WAO) recommendations. In addition, the Committee also requested responses to the Auditor General's recent reports on public funding for Penmon Fish Farm and the Cywain Centre. I am pleased to confirm that all of the recommendations contained within these three reports have been accepted. The progress of the Welsh European Funding Office (WEFO) in implementing the recommendations of each report is summarised below.

European Union Structural Funds 2007-2013

This was a generally positive report and it picked up on a number of points that have been raised previously. Four recommendations (R3[a], R6[a], R7[c] & R12[a]) have already been implemented in full. A further three have been partially implemented (R1, R4[b] & R7[b] and work on these is continuing. The remaining recommendations will either be fully implemented by the end of 2014 (subject to the approval by the European Commission of the UK Partnership Agreement for the 2014 – 2020 funding period and the individual Operational Programmes for Wales) or, for those relating to the monitoring of operations, will be progressed as the implementation of the new Programmes gets under way.

Public Funding of Penmon Fish Farm

We accept all the recommendations from the report. The events are some time in the past and the control environment has been strengthened significantly over the intervening period. The issues raised have now been addressed.

Recommendation 1 is that grant recipients be required to comply with UK law. The Welsh Government highlights key statutory requirements and obligations in its funding agreements but notes that the scale of this requirement is such that it will not be possible for the Welsh Government to monitor compliance across all areas as a matter of routine.



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Recommendation 2 is accepted and WEFO's management verifications have been extended to cover transactions between a grant recipient and a supplier that is a related company. For example, testing transactions between the related companies for reasonableness or treating the related companies as a single entity when testing supplier expenditure.

Recommendation 3 is accepted. WEFO has put in place arrangements to coordinate the provision of expert advice from internal and external sources (e.g. technical and specialist advice on bio-sciences, marine sciences etc) to ensure that project proposals are set up effectively, represent added value and are technically feasible.

Recommendation 4 is accepted. The Grants Centre of Excellence project has already strengthened processes across the Welsh Government for communications on grants management.

Public Funding of Cywain Centre

Recommendation 1 reflects Recommendation 4 from the Penmon Fish Farm report and is accepted. Action is being taken to strengthen processes in line with the Grant Centre of Excellence project.

Recommendation 2 is also accepted, whilst recognising that a clear legal basis will be required for taking the kind of steps proposed. The current Structural Fund regulations (Article 57 of EC Regulation 1083/2006) requires investments in infrastructure and productive investment to be safeguarded for 5 years from the date of completion. Further work is being undertaken to identify the most appropriate and practical approach to extending this protection. This could mean, for example, requiring a legal charge on grant funded assets in the grant offer letter to ensure that the assets continue to be used for the purpose for which they were funded. On balance, we agree that the need to protect public investments means that this should be done, but we acknowledge that some beneficiaries would make a counter argument, saying that this would restrict their use of that asset to secure additional funds and make further investments. The exact nature of the controls that might be appropriate will vary depending on the nature of the project.

Additional Issues

To help in the Committee's consideration of the report before its meeting on 12 June, it has also requested that the Welsh Government address the following issues. Each issue is therefore accompanied by a Welsh Government response.

- **An update on the Welsh Government's approach to setting ESF targets for the new programming round including details of work being undertaken to ensure that targets are appropriately challenging.**

Response:

All targets are set and agreed with the Commission either as part of the negotiation of the Programmes at the outset or during subsequent programme modifications. Our proposals for the 2014-2020 ESF Programmes will see an even greater emphasis on individuals who are at most at risk of poverty, exclusion and disadvantage. The challenge of helping those at greatest disadvantage in the labour market will of course need to be reflected in setting targets for the next round of Programmes. Targets will be negotiated on the basis of historical performance data for Structural Fund and other public investment programmes, drawing on National Statistics where available. Both the Welsh Government and the

European Commission share an interest in agreeing stretching but realistic targets which will demonstrate good value for money in the use of ESI Funds. It should also be noted that the new programmes will have a stronger emphasis on results, including the use of a Performance Reserve mechanism to reward or penalise programmes for over or under performance respectively.

- **Action that the Welsh Government is taking to improve performance on these cross-cutting themes, both for the final period of the 2007-2013 programmes and for the 2014-2020 programmes.**

Response:

WEFO is taking a number of specific actions to address the issues identified:

- Completion of intervention logic tables by applicants, demonstrating precisely how the operation (project) outputs and outcomes and activities will align with stated and specific programme objectives and achieve on all identified Cross Cutting Theme (CCT) indicators.
- The CCT indicators for the 2014-2020 programmes will be more closely aligned with mainstream priority level activity, reducing the requirement on beneficiaries (sponsors) to deliver separate activity to delivery CCT objectives.
- Training workshops on the integration of the CCT's in the 2014- 2020 programmes are being delivered for WEFO staff and those delivering operations. Training needs in this area will be regularly reviewed throughout the life of the programmes.
- In developing the new programmes, emphasis has been on the need for beneficiaries to give more detailed plans on how their activity will contribute to the CCTs.
- The CCT Team has been expanded and will have a broader remit across all European Structural & Investment (ESI) funds, including rural and maritime programmes, and will be better able to identify needs and opportunities.
- WEFO will continue to share good practice examples on CCT integration and encourage operations struggling with their CCT commitments to learn from others.
- **What monitoring arrangements the Welsh Government has in place to determine the extent of larger companies setting up small scale bases in Wales and how procurement processes define a Welsh-based company.**

Response:

Procurement legislation prohibits discrimination on the basis of supplier location. Therefore, the procurement process would not necessarily favour any business setting up a small-scale operation in Wales. For the purposes of monitoring, indigenous Welsh businesses are identified on the basis of Companies House records. In the context of Community Benefits measurement, Wales based businesses are defined as those who perform a significant part of the project in question from an office based in Wales, therefore having a greater prospect of employing and paying people who reside in Wales.

In respect to the Structural Funds, the Welsh Government collects details on those organisations which obtain procurement contracts. Using current data from the 2007-2013 programmes, the private sector has been awarded 60% of all procured contracts. In 2011, WEFO undertook an exercise to establish whether companies benefiting from the procurement of EU projects **Part Page 16** Company (wholly based within Wales); a

company with a Welsh Presence (for example a national company that has a presence in Wales); or a company that is based outside Wales (typically national or international companies). This research found that there were a total of 1431 contracts worth £700k, with 69% of these going to Welsh Companies and 13% to companies with a Welsh Presence. WEFO plans to repeat this research exercise later in 2014.

- **A) The Committee is interested in any other measures of prosperity that the Welsh Government may be able to provide or point to that compares the impact of Convergence Programme funding in Wales with the impact of the equivalent funding in other EU regions.**
- **B) Any evidence that the Welsh Government may have to quantify the possible impact of out commuting.**

Response:

Gross Domestic Product (GDP) or Gross Value Added (GVA) is used by the European Commission to determine Structural Funds allocations (which have already been set for the 2014–2020 period) and is a measure of the economic activity taking place within an area. The measure can be particularly misleading in the West Wales & the Valleys (WW&V) region which experiences large out-commuting flows and can depress the GVA estimates, as recognised by Eurostat.

To measure the success of economies it is important to look at a basket of indicators – for example, employment rates and income levels, which particularly matter in people’s well being. Here, our performance is better and since the late 1990s there has been a marked and sustained closing of historical gaps between Wales and the UK. Before devolution, the employment rate in Wales was typically 5-6 percentage points below that for the UK. Over the last few years the gap has generally been less than 3 percentage points, and even less than this over the more recent past. Since 1999, employment in Wales has increased by 157,000 or 13 per cent compared to a 12.2 per cent increase for the UK as a whole.

With disposable income a better indicator of living standards than GDP, Wales compares well or performs better than it does on GDP relative to the EU (based on Eurostat figures for disposable income per capita at purchasing power standard based on final consumption per inhabitant for 2010).

In terms of measuring the potential impact of out commuting across West Wales and the Valleys, the socio-economic analysis undertaken in preparation for the 2014-2020 programming round found that overall GVA per head between 2009 and 2011 was approximately £2,100 less than the average for Wales as a whole. Analysis of this gap in more detail revealed that 25% - 30% of the overall gap is explained by residents of West Wales and the Valleys commuting outside the area for work - GVA created by net out commuters is not attributed to the Programme area.

Yours sincerely



Michael Hearty
Director General, Finance & Corporate Services



WALES **AUDIT** OFFICE
SWYDDFA **ARCHWILIO** CYMRU

18 December 2013
www.wao.gov.uk

Public Funding of Penmon Fish Farm



Public Funding of Penmon Fish Farm

I have prepared this report for presentation to the National Assembly under the Government of Wales Act 2006.

The Wales Audit Office study team comprised Alastair McQuaid with assistance from Ian Hughes, Ben Robertson, Nick Davies and Chris Pugh, under the direction of Paul Dimblebee.

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**Report presented by the Auditor General for Wales to the
National Assembly for Wales on 18 December 2013**



Photo courtesy of Anglesey Aquaculture Ltd

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Summary

- 1 In July 2001 Bluewater Flatfish Farms Ltd opened a land-based fish farm in a disused coastal quarry near Penmon, Anglesey. The farm produced turbot and created eight jobs. Bluewater Flatfish Farms' Greek parent company, Selonda SA, established a subsidiary, Selonda UK, to develop a further, larger fish farm (Penmon Fish Farm) to produce halibut in the quarry. The Penmon Fish Farm project (the Project) cost £11.9 million and received over £5.2 million of public funding.
- 2 The Project was originally due to be completed in 2003, but it experienced delays and difficulties, partly because of problems with the technology involved, and it did not become operational until 2009, producing sea bass. The Welsh Government signed off the Project as complete at the end of December 2008 because the European grant scheme, under which grant funds were provided, ended then, and the Project was assessed as achieving its objectives, which were an operating plant and 30 jobs. By early 2009 claims for all of the eligible expenditure had been submitted and the full amount of grant and match funding approved was paid by the Welsh Government.
- 3 However, key aspects of Penmon Fish Farm were not operating as originally planned, including a mains electricity power supply, a wetland filtration system and an effluent discharge pipe. In April 2010, Isle of Anglesey County Council served a noise abatement notice on the farm's operators for noise arising from diesel generators. In October 2011 Selonda UK pleaded guilty to allowing effluent and chemical waste to pollute the natural environment; and in February 2012, the former managing director was found guilty of having allowed the pollution to take place.
- 4 In late 2011 Selonda UK experienced cash flow difficulties and in January 2012 the company's assets were sold by administrators for £1.2 million to Anglesey Aquaculture Ltd. The plant's new owners continue to farm sea bass and are investing to address the technical problems and ensure the plant operates within environmental regulations.
- 5 In 2012 the Auditor General received correspondence from the Chairman of the Public Accounts Committee and another Assembly Member expressing concerns about the value for money the Welsh Government had secured from the public investment in Penmon Fish Farm. Following an initial review, the Auditor General decided to extend the scope of the review to encompass the Welsh Government's role in managing and monitoring the grants to Penmon Fish Farm, and to publish a report that would aim to answer the question:

Did the Welsh Government manage the public investment in Penmon Fish Farm in a way that maximised the benefits of the investment?



6 Overall, we concluded that:

The Welsh Government followed its procedures for approving and monitoring grant funding of the Project. However, the procedures at that time were less robust than those in place now and were unsuited to a project of this scale, complexity and risk. Although the Project achieved its main objectives, problems arose when the fish farm began operating which caused pollution and nuisance.

7 In reaching this conclusion we found that:

- a the Project offered potential economic and environmental benefits in return for considerable public and private investment, but it encountered problems that resulted in delays and increased costs;
- b the Project delivered a fish farm which has brought some benefits, and action has been taken to address problems of noise and pollution;
- c the Welsh Government identified potential risks when it approved grant funding for the Project, but did not put in place grant conditions that would have helped mitigate the risks;
- d the Welsh Government's monitoring of progress focused insufficiently on the risks identified during the Project's appraisal; and
- e the funding regime for European grants has been strengthened in recent years and, as a result, arrangements for managing complex projects have improved.

Recommendations

Building upon improvements in the Welsh Government's arrangements for grant funding projects following previous Wales Audit Office and Public Accounts Committee reports, we have identified some areas for further improvement and make the following recommendations:

- R1** To address the risk that a grant-funded project may meet the conditions of the grant whilst failing to comply with legal, fiscal and regulatory requirements or ethical standards of business conduct, the Welsh Government should:
 - Investigate the feasibility of including within grant offer letters a general condition that makes compliance with UK law, regulations, taxation and standards of conduct in business a standard condition of grant.
- R2** To address the value for money and fraud risks associated with procurement transactions between a grant recipient and a supplier that is a related company, in validating grant claims the Welsh Government should:
 - Test transactions between the related companies for reasonableness, or treat the related companies as a single entity and test the suppliers' expenditure.
- R3** To reduce the risk that complex projects involving specialist technical requirements may not be completed as required or may deliver poor value for money, in addition to accessing expertise from within the Welsh Government to assist project monitoring teams, the Welsh Government should:
 - Commission individuals with appropriate industry or technical expertise to support project monitoring teams.

R4 To improve the management of project risks and the effectiveness of enforcement action, where appropriate, the Welsh Government should:

- Strengthen communication and co-ordination between the different grants management teams within the Welsh Government and with external regulatory bodies.

Penmon Fish Farm is a land-based facility for farming sea fish



Photo courtesy of Anglesey Aquaculture Ltd



Part 1 – The Penmon Fish Farm project offered potential economic and environmental benefits in return for considerable public and private investment, but it encountered problems that resulted in delays and increased costs

Penmon Fish Farm aimed to establish an environmentally sensitive aquaculture facility in North Wales, based on innovative technology

- 1.1** The Bluewater Fish Farm was established in 2001 at Dinmoor Quarry, near Penmon in Anglesey, to produce turbot. Based on the anticipated success of Bluewater Fish Farm, its Greek parent company, Selonda SA, sought further expansion at the quarry by means of a large-scale halibut farm (Penmon Fish Farm).
- 1.2** Selonda SA established a subsidiary, Selonda UK (the Company), for the purposes of the Penmon Fish Farm project (the Project). In June 2001, Selonda UK applied to the Welsh Government¹ for public funding to support substantial private investment in the new facility. The Project was forecast to cost a total of £10.3 million, of which £6.2 million would be invested by the private sector, and 30 jobs were predicted.
- 1.3** It was expected that the facility would be the largest closed recirculation fish farm in the world. The size and complexity of the planned operation presented considerable challenges that required innovatory technological solutions. The Project involved hatching fish fry and growing them to maturity on land, in large indoor tanks containing treated seawater drawn from the sea via an inlet pipe and pumped around the tanks. Levels of oxygen, food, acidity, temperature and salinity needed to be constantly monitored and carefully managed to optimise growing conditions. Waste water and effluent were to be filtered, passed through artificial wetland reed beds and discharged back into the sea.
- 1.4** The proposed plant was to be situated in an area designated as being of outstanding natural beauty and within a region, North Wales, in which traditional fishing had declined and unemployment was relatively high. Therefore, in its funding application documents the Company stressed the Project's environmental friendliness, in terms of energy efficiency, visual impact and low emissions, as well as its potential economic benefits.
- 1.5** The Project received widespread political support at local and national levels because of its claimed benefits. The stated aim of the Project was to develop the '...first fully sustainable fish processing plant in Wales. This Project will minimise the release of organic material to the environment through the combined use of advanced recirculation technology and a recycling of nutrient wastes by the creation of a managed wetland.'²

¹ For the purposes of this report, the general term 'Welsh Government' is used unless for reasons of clarity it is appropriate to identify an individual department or team.

² Selonda UK FIFG grant application form, June 2001

1.6 The Welsh Government granted European Union (EU) Financial Instrument of Fisheries Guidance (FIFG) grant funding to the Project, along with match funding. The grant recipients and the Welsh Government envisaged the Project as the first stage in establishing a new industry in Wales. A fish processing plant, for which additional funding would be sought at a later date, was to be the second stage. The grant offer letter stated that the quantifiable outputs from the first stage, the fish farm, would be: one aquatic development supported and 30 gross jobs created. The grant application form, submitted to the Welsh European Funding Office (WEFO)³ in June 2001, along with its supporting documentation, emphasised that the Project would:

- a** deliver an aquaculture facility utilising world-leading recirculation technology and create 30 jobs;
- b** establish a new, sustainable land-based fishing industry on the island of Anglesey, in harmony with the environment;
- c** achieve a minimum production of 1,000 tonnes of halibut a year which, alongside the 600 tonnes of turbot a year anticipated from Bluewater Fish Farm, would provide enough output to initiate a fish processing facility which could have the potential to create a further 25 jobs with associated economic benefits;
- d** create a 2.5 hectare saline wetland, which would provide a habitat for wildlife, specifically wading birds, and minimise the release of effluent into coastal waters in an environmentally sensitive way; and
- e** contribute to achieving national, regional and local development and regeneration objectives.

The Project fell behind schedule, costs and demands for public funds increased, and problems culminated in the financial failure of the grant-recipient company three years after the Project was completed

1.7 The Project to build the fish farm experienced problems and delays from the outset. The Project's planned milestones, as set out in Selonda UK's original grant application of June 2001, were:

- a** site preparation to start in November 2001 and construction to start in December 2001;
- b** production and hatchery plant to be completed by April 2003; and
- c** full production by January 2006.

1.8 Grant funding of £3.6 million for the Project was not approved until July 2002. The Project's funding from private sources included £3 million from a partnership of Icelandic fishing companies, but in August 2002 the Icelandic partnership withdrew its support for the Project. In February 2003, Isle of Anglesey County Council refused an application for £50,000 of grant support because the funds for this originated from EU Objective 1, which meant that the limits on EU funding for the Project would have been exceeded. The FIFG grant offer letter states that in the event of a decrease in private funding, EU grant funding will not increase. To meet the shortfall, in January 2003 the Welsh Government agreed to increase its match funding from £464,494 to £1.5 million⁴, and in March 2003 Selonda SA increased its share of the private funding.

³ WEFO is responsible for managing various European grant schemes in Wales.

⁴ Welsh Government match funding approval and payments were managed separately from the FIFG grant, by the Fisheries Policy Unit.



- 1.9** In April 2003 a WEFO site visit identified that no work had been started on-site. Some progress was made subsequently, but in June 2004 WEFO raised concerns about the slow progress. In May 2005 WEFO wrote to Selonda UK, threatening that unless the Project was completed quickly, the FIFG grant for the Project would be cancelled and reclaimed, in order that it could be committed to another project to avoid FIFG scheme funds having to be returned to the EU. The Project made some further progress but this continued to be sporadic.
- 1.10** The variety of construction and other technical problems experienced by the Project also led to total estimated costs increasing from £10.3 million to £12.0 million. The private financing component increased from £6.2 million to £6.9 million in 2007. In March 2006 Selonda UK requested and received an exceptional payment of £622,500 from existing Welsh Government match funding to meet deposits required by construction contractors.
- 1.11** WEFO regarded Project completion as being the full amount of eligible expenditure being claimed; the end of the funding scheme; and/or, full delivery of the Project's target output indicators. Five per cent of the grant could be held back until the target indicators were delivered. The Project was classed as financially completed at the end of December 2008, when the FIFG funding scheme terminated. Selonda UK submitted the final grant claim to WEFO at the end of February 2009 and the final payment from WEFO to Selonda UK in March 2009 completed the full payment of FIFG grant to the Project. The plant began operating in early 2009.
- 1.12** Subsequently, Selonda UK requested more grant funding, in addition to the FIFG grant and Welsh Government match funding it had already received. These additional grants were £2,920 Agri-Food Development Scheme grant in March 2009 for Project marketing and branding; £43,432 European Fisheries Fund grant⁵ in August 2009 for a fish stunning and sorting plant, with £31,000 of Welsh Government match funding; and a further £27,000 grant in August 2011 for power supply.
- 1.13** In the first 11 months of 2011, Penmon Fish Farm had made a net loss of £1.9 million,⁶ and Selonda UK Ltd experienced cash flow difficulties and had insufficient working capital to pay for fish food and oxygen. Without these essential commodities; thousands of fish were at risk of death. The Welsh Government's Fisheries Policy Unit provided £40,000 to suppliers for deliveries in order to address the immediate difficulties. However, the Company was unable to raise further private funding and in January 2012 it was liquidated and its assets were sold for £1.2 million to a Dutch company, which has operated the fish farm since then, under a subsidiary company, Anglesey Aquaculture Ltd. The new owners also paid an additional £0.6 million to settle debts and secure fish food supplies. Bluewater Fish Farm had ceased operating in 2009, and was liquidated in November 2012 and its assets were sold to another subsidiary of the same Dutch company as Anglesey Aquaculture Ltd, for £165,000.

⁵ European Fisheries Fund grants were made under the successor EU scheme to FIFG.

⁶ Liquidator's Statement of Insolvency, January 2012

Part 2 – The Project delivered a fish farm which has brought some benefits, and action has been taken to address problems of noise and pollution

The Project delivered an operating fish farm, created direct jobs and encouraged the relocation of technical expertise to Wales, but some other wider benefits that were anticipated have yet to be realised

- 2.1** Although the project was completed much later than had been planned at the outset, the Welsh Government is satisfied that the Project was successful. 'In this instance WEFO and European Commission (EC) officials are satisfied that the Project, in line with EC regulations, fulfilled the terms and conditions of grant and the respective outputs which were essentially to create 1 aquaculture farm and 30 gross jobs'.⁷
- 2.2** The first of the two target outputs of the Project was achieved in early 2009 when the plant began operating. The second target output of the Project was to create 30 jobs. The Welsh Government assessed that the Project had achieved this. By the end of December 2008, when the FIG scheme ended, 17 jobs were identified; monitoring during July 2009 identified 28 jobs; and Project closure at the end of July 2009 identified 33 jobs created. The FIG programme and the grant offer did not specify whether these should be new jobs and UK law does not permit them to be specified as jobs only for local people. It is likely that
- a small number of managerial jobs went to existing Selonda staff from outside Wales, and only some of the balance of the jobs, mostly low paid, was taken by local people. It is not clear how many of the jobs at Penmon Fish Farm were taken up by former staff from the neighbouring turbot farm, which had created eight jobs but ceased operations during 2009 and has been used as a packing plant since then.
- 2.3** An economic appraisal of the Project, undertaken for WEFO in July 2001, calculated the cost per job to the public purse as £137,000 on the basis of 30 jobs and expected public funding at that time of £4.1 million. The appraisal concluded that this was exceptionally high, compared with the average cost per job of £17,500 generated by the Regional Selective Assistance Programme 1991-1995. The economic appraisal concluded that this represented poor value for money. Taking the total FIG grant and match funding together, the actual cost per job was more than £170,000. This figure does not include subsequent smaller grant payments made to Selonda UK, which would make the cost per job figure even higher.
- 2.4** Anglesey Aquaculture Ltd told us that under new ownership the fish farm currently employs 26 staff, working in shifts. This suggests that the Project has been successful in generating sustainable jobs, although at high cost. However, it is not yet clear whether, under new ownership, the Project has resulted in a viable and sustainable business. Anglesey

⁷ Correspondence from Welsh Government Department of Rural Affairs in response to a question from an Assembly Member, 5 October 2010.



Aquaculture Ltd told us that it has already made a significant investment in the plant to address technical problems which the new owners believe will enable it to operate satisfactorily and profitability within the next couple of years. To date, its total investment has been approximately £5.2 million.

2.5 Although the cost per direct job created was high, a value for money assessment should also take into account any other, wider, benefits achieved. One of the key reasons for approving the Project was its potential to position Wales at the forefront of a new technology-based aquaculture industry. Information from the Welsh Government's Project files indicates that the main supplier to the Project, IAT,⁸ established an office in Gaerwen, near Llangefni, Anglesey to service the contract with Selonda for building the plant, and in 2002 advertised for two posts to manage the construction. IAT relocated its entire operations to Llangefni in 2003, bringing 20 jobs, and currently employs 28 staff there. IAT continues to provide services to the new owners of the fish farm. IAT's website shows aquaculture projects which it is involved in worldwide, and we understand from Welsh Government officials that IAT is now a Wales-based industry leader in recirculation technology expertise.

2.6 Selonda UK abandoned its plans for a further phase of the Project, a fish processing plant, and to date no other aquaculture plants utilising recirculation technology have been developed in Wales. However, Welsh Government officials told us that they have received several inquiries from potential investors who may be interested in locating aquaculture projects in Wales, using recirculation technology, particularly if the fish farm at Penmon becomes successful.

Some components of the fish farm were not completed as originally specified, and nuisance and pollution undermined the Project's claims to be environmentally sensitive and sustainable

Problems in establishing a mains electricity supply sufficient for the fish farm's needs led to noisy diesel generators being used, creating a nuisance

2.7 In 2001 Selonda UK's application for FIG grant funding identified £487,000 of expenditure for which grant support was required to be used for power supply. This was needed because the existing mains electricity link to the quarry, used to supply the Bluewater Flatfish Farm, would be inadequate to meet the farm's continuing needs, the Project's requirements and to provide for potential expansion in the future. The environmental statement, prepared to support the grant application and the application for planning permission, stated that mains electrical power would be supplied through a new power line that would be constructed as part of the Project. This would require an upgraded 33,000 volt link to the fish farm from Beaumaris substation.

2.8 The FIG grant approval process required all relevant consents to be in place prior to application submission, but in this case the application was accepted in advance of planning consent from Isle of Anglesey County Council or a permit to abstract water and discharge waste from the Environment Agency⁹ being obtained. WEFO granted

⁸ IAT is referred to variously as International Aqua Tech (IAT) Ltd. [Selonda UK. Business Plan 2001; Selonda SA. Annual Report 2004]; International Aquaculture Technologies (IAT) Ltd. [WEFO documentation]; Intensive Aquaculture Technology (IAT) Ltd [WEFO procurement notes]; Integrated Aquaculture Technology (IAT) Ltd [Selonda UK. Environmental Statement 2001].

⁹ The Environment Agency's operations in Wales are now undertaken by Natural Resources Wales. For the purposes of this report, the name in place at the time is used.

this exception to allow the project appraisal process to commence because appraisal was expected to be a lengthy process due to the complex, technical nature of the Project.

- 2.9** Isle of Anglesey County Council granted planning consent for the fish farm in February 2002. The consent specified that a separate application would be required for a mains power supply, but obtaining this additional consent for electricity supply was not a condition of planning consent for the fish farm. The planning consent and discharge permit were both in place before the grant was approved.
- 2.10** The FIGG grant application was approved in July 2002. The grant offer letter did not specify that the power should be supplied from the National Grid, but it is clear that the £487,000 of Project expenditure eligible for grant support was for the purposes set out in the documents supporting the grant application, which specified a new mains link and estimated the cost of establishing it.
- 2.11** In June 2007, Selonda UK identified that the costs of establishing the power supply from the National Grid had increased to more than £1 million. Selonda UK had encountered difficulties in concluding agreements with 23 landowners over whose land the supply would be routed. In October 2007 Selonda UK had identified that power supply completion was likely to extend beyond the planned Project completion date of 31 August 2008 and requested an extension of the Project completion deadline to 31 December 2008. Negotiations with landowners were concluded by August 2008 and, in correspondence with WEFO, Selonda UK stated that it would proceed with planning for the installation of the power supply but would be unable to commence construction of the power lines until spring 2009, with expected completion

that summer. In the meantime, the electrical power to the plant's pumps and tanks was installed, along with an electrical substation intended to link with the new mains supply, and Selonda UK submitted grant claims to WEFO for the eligible expenditure involved.

- 2.12** The Project was financially complete at the end of December 2008 and the final grant payment was made to Selonda UK in March 2009. By then all eligible expenditure in respect of the power supply had been incurred and the full grant claimed and paid. Payments were based on claims submitted by Selonda UK, supported by audit certification. At the end of the Project the power supply costs had increased above the £487,000 approved within the Project to over £1 million. Selonda was required to meet the extra costs of completing the power supply. Normally, if ineligible costs were involved in completing a project, WEFO would expect these to be incurred during the period of the project along with all eligible expenditure. However, in October 2008, WEFO accepted that all of the ineligible expenditure in relation to the power supply would not be incurred before the end of the FIGG scheme. The effect of this approval was to remove power line installation completion from the Project.
- 2.13** In March 2009 (after the end of the Project and after receipt of the final grant payment) Selonda UK made a planning application to Isle of Anglesey County Council for the mains power supply, but subsequently withdrew it. Estimates from the energy company of the cost of establishing the link and supplying mains power had risen significantly and negotiations between the energy company and Selonda UK had stalled. Since then, no further planning application for the new mains electricity link has been submitted.



2.14 The fish farm began operating in early 2009 using some mains power from the existing supply. This was supplemented by electricity generated on-site by diesel generators because the existing supply was insufficient for the plant's needs. Selonda UK kept Welsh Government officials informed about the difficulties, delays and escalating costs associated with the mains power supply and WEFO agreed to the use of generators, without which the fish farm could not have begun operating. In April 2010, following complaints from local residents, Isle of Anglesey County Council served a noise abatement notice on Selonda UK because low-frequency noise from its diesel generators was causing a nuisance. In response, Selonda UK brought in quieter diesel generators which remained in continuous use to meet the plant's needs.

2.15 In August 2011, the Welsh Government provided a further £27,000 to Selonda UK specifically for power supply¹⁰. The payment was made as part funding for an £85,000 project to provide a sustainable power supply for the fish farm, planned to be completed in March 2012. Selonda UK was to provide the balance of £58,000.

2.16 The fish farm's new owners, Anglesey Aquaculture Ltd, took over the plant in January 2012 and, in May 2012, completed the project to uprate the existing mains power supply to the quarry which had previously served Bluewater Flatfish Farm. Because Bluewater Flatfish Farm ceased operating in late 2009, the uprated supply is capable of meeting the plant's present needs, without the 33,000 volt link to Beuamaris and without the requirement for diesel generators in continuous operation, which have been removed recently. A single diesel generator remains on-site for use as a back-up supply in the event of a mains power failure.

The technological and environmentally friendly aspects of the Project were not delivered in accordance with the Project's claims, and the plant breached environmental regulations

2.17 The FIFG grant application form and supporting documentation stressed that the Project would have a minimal negative impact on the environment, and specified that effluent emissions would be controlled by using recirculation technology and by establishing an artificial wetland filtration system. The artificial wetland would comprise 2.5 hectares of saline reed beds to filter the outflow from the plant, which would then drain into the sea. According to the grant application and the supporting documentation, the wetland and reed beds would increase biodiversity and provide a habitat for wading birds and invertebrates. The wetlands were identified in the FIFG grant offer letter as an eligible cost of £513,000, against which grant could be claimed.

2.18 In March 2002 Selonda UK started the process of obtaining permits from the Environment Agency to extract water from the sea and discharge filtered effluent back into it. Permits were issued in June 2002 specifying the pipework for the intake and outflow, which was to extend to below the low-water mark. The discharge permit set out metering and monitoring requirements to ensure that the Company complied with the permit in relation to aspects of the effluent, including tidal conditions, volume, chemical composition and suspended solids. The Environment Agency also specified planting density requirements for the effective operation of the reed beds. The permits' requirements were more extensive, detailed and demanding than the descriptions in the grant application and supporting documents.

¹⁰ The documents we have seen identify that this additional funding for power supply was approved by the Business Minister and the Deputy Minister for Food and Fisheries, and was paid to the power company in August 2011.

- 2.19** A report following a monitoring visit by WEFO in June 2006 stated that the wetland was functioning satisfactorily with waste from the neighbouring Bluewater Flatfish Farm. However, problems emerged once the Penmon Fish Farm began operating and generating larger volumes and concentrations of effluent. The filtration system within the plant was failing to remove fine particles of fish waste before effluent was fed into the wetland reed beds. The reed beds were intended to remove dissolved organic waste naturally, not to filter out solids. Consequently, the artificial wetland became choked with fish faeces, the reeds died and the reed beds stagnated and became foul smelling. Thereafter, the artificial wetland filtration system in operation involved the use of filtration sacks. The additional costs of the filtration sacks were ineligible within the Project and were met by Selonda UK.
- 2.20** In August 2010, after the Project had been completed and 15 months after Penmon Fish Farm started operating, the Environment Agency received complaints from the public about pollution from the plant. The Environment Agency investigated the complaints and prosecuted Selonda UK for breaches of environmental regulations, which involved the unlawful discharge into the sea of trade effluent and chemicals. Evidence given during the prosecution identified that the wetland filtration system was not operating effectively, and systems for metering and monitoring discharges from the farm were not in place. The outflow pipe had not been constructed as specified by the Environment Agency permit; instead of a submerged discharge pipe extending from the wetland into the sea to below the low-water mark, a short pipe discharged effluent over the rocks. Selonda UK pleaded guilty in October 2010 and was fined £50,000. In February 2012, the former managing director of Selonda UK was found guilty of having allowed the pollution to take place.
- 2.21** The FIGG grant application had stated that the farm's visual impact from the seaward side would be mitigated by a constructed embankment, which would also serve to safeguard against any spillages from the facility entering the sea. The embankment would be enhanced by landscaping and planting, which would comprise 'an earth bund seeded with coastal plant species' which would 'be targeted at improving foraging and breeding habitat for bird species'. However, the landscaping and planting work was not included in the application as expenditure to be eligible for grant support, and no grant funding was provided. In the event, the works were not completed as described.
- 2.22** In March 2009, Selonda UK received a grant from the Welsh Government of £2,920 towards the cost of producing marketing materials. Selonda's promotional materials included brochures stressing the Project's green credentials and referring to the wetland filtration system. The materials were produced soon after the fish farm began operating and before Selonda UK was prosecuted for breaches of environmental regulations. However, the Project's green credentials were undermined subsequently by the use of diesel generators on-site, the failure of the filtration systems and wetland to process effluent effectively, and the release of chemicals into the sea.



2.23 In September 2012, the Environment Agency issued a new discharge permit to Penmon Fish Farm's new owners, Anglesey Aquaculture Ltd. The terms of the new permit increased the permitted volume of discharge per day but reduced the permitted levels of contaminants in the discharge, compared with the original permit. The new permit also requires that improvement work is undertaken by the plant's operators which will involve constructing a discharge pipe. The Environment Agency and the Welsh Government have informed us that Anglesey Aquaculture Ltd is working with them closely

to address the problems which gave rise to the pollution incident, including improving filtration within the plant, upgrading the wetlands and installing the discharge pipe. However, the Environment Agency informs us that at present, geological issues are causing problems with constructing the submerged discharge pipe. In the meantime, effluent continues to be discharged over the rocks from a pipe above the shoreline but its content is controlled and monitored by the operators and periodically checked by the Environment Agency.

The Fish Farm utilises advanced recirculation technology to maintain optimal growing conditions



Photo courtesy of Anglesey Aquaculture Ltd

Part 3 – The Welsh Government identified potential risks when it approved grant funding for the Project, but did not put in place grant conditions that would have helped mitigate the risks

The Project application and supporting documentation met the criteria of the grant funding scheme

3.1 The EC's FIG grant application process involved checks by WEFO that all of the documentation required was completed properly, and that the Project met the criteria for the European grant funding scheme¹¹, which are linked to EU policy objectives. WEFO provided pre-application advice to potential applicants for European funding to ensure that they were directed towards the most relevant sources of funding for their project and understood the requirements of the scheme. Support was also available from WEFO to help applicants to complete application documentation appropriately. The Selonda UK grant application was made under the EU's Objective 1 programme, which aimed to increase economic output. Specifically, Selonda UK sought assistance from the FIG under Priority 5 (rural development and the sustainable use of natural resources), Measure 9 (support for fisheries and aquaculture).

3.2 Supporting documents submitted with the application form, which constitute part of the application, included a business plan with financial projections and an environmental statement. These documents contained general descriptions of the plant and how it would operate, emphasised the Project's ecological and environmental credentials, and included extracts from and references to a

range of policies to demonstrate compliance with legislation in areas such as equalities, as required by the FIG grant scheme. Neither the grant application form nor the supporting documentation contained detailed technical specifications of the plant or construction plans for the fish farm to underpin Selonda UK's assertions about the fish farm's environmental impact, and these were not required by the grant scheme. The scheme did, however, require local authority planning permission and permits from the Environment Agency to be in place, which placed more detailed requirements upon the construction and operation of the fish farm than the FIG grant conditions.

The Welsh Government's appraisal of the application identified that the Project was ambitious, costly and risky, but if successful it could establish a centre of expertise in Wales

3.3 The Welsh Government assessed the Project in July 2001. WEFO led the assessment and sought advice from other divisions and departments of the Welsh Government, including Rural Affairs and Agriculture and Fisheries, and external legal advice was obtained to determine whether the Company was eligible to receive European Structural Funds. The Project's technical assessment resulted in the highest possible score of one (on a scale from one to five) on the level of fit with the needs of the region. Other aspects of

¹¹ The aims of FIG grant, set out in appendices to the grant offer letter, were: 'helping achieve a sustainable balance between marine resources and their exploitation; modernising fishing structures to ensure the future of the industry; helping maintain a dynamic and competitive fishing industry and revitalise areas dependent on fishing; improving the supply and exploitation of fishery products'.



the Project were also scored on a one to five scale and the total of these scores was used to generate a technical assessment rating. These aspects comprised:

- a** need for the Project, including rationale, justification, problems it seeks to address, impact, and compliance with statutory requirements and state aid legislation;
 - b** management and delivery of the Project, including likelihood of the Project being well-managed and the expected impacts delivered, track record of Project delivery and/or business success, appropriate skills and experience, realistic and achievable timetable for delivery and completion, a clear and workable exit strategy, and plans for publicising and promoting success;
 - c** additionality, displacement and substitution – providing additional activity and the need for public funding, not displacing other existing businesses or activities, and integration with other established projects;
 - d** providing benefits to the wider rural economy;
 - e** addressing cross-cutting objectives relating to environmental considerations, IT and equal opportunities; and
 - f** environmental and social impact and sustainability – positive contribution to environmental quality, economic strength and social equity.
- 3.4** The Project scored nine across these other aspects, placing it in the highest priority category of H.¹² Combined with the regional needs score of one, this gave an overall technical assessment of H1, which is the highest priority for grant support. The Welsh Government strongly recommended approval of the Project because, in addition to the high

assessment score, it built on the previous investment in the Bluewater Fish Farm on the same site. It represented a major investment in recirculation technology as part of a wider strategic intention of establishing Wales as a leader in this field, with an expectation that such technology would play an important role in future food production.

- 3.5** The potential for aquaculture of the type envisaged by the Project had been recognised within the fisheries industry for some time, but development had been inhibited because of the risks involved. The Welsh Government hoped that a successful venture would encourage further investment. The technical appraisal included the comment 'It is difficult to see another project which is likely to have such a positive effect on the fisheries sector in Wales, provided it is taken to its conclusion'.
- 3.6** Public grant funding regimes accept a higher level of inherent risk associated with projects than commercial funding streams would tolerate, in order to achieve wider social and economic benefits. A criterion for grant funding is that projects would probably not proceed without grant funding to support the amount of capital investment required. Furthermore, grant-funded projects are frequently unprofitable in the short-term. To ensure that public funds are not used to generate excessive profits for the private sector, grant conditions may require that projects are not profitable for a specified period following the last grant payment.
- 3.7** In addition to these inherent risks, the appraisal led by WEFO identified a number of specific risks to the Project. These included:
- a** Technical risks associated with the proposed design and build of the facility – including the use of land-based recirculation technology untested on this

¹² The best possible aggregate score is six; the worst is 30. The total is used to generate a rating of project suitability and quality expressed as high, medium or low. The Project scored one for the aspects of satisfying needs, management and delivery, and environmental and social sustainability. The Project scored two for the other aspects.

scale; saline wetland filtration, a system in use for freshwater but not seawater; potential difficulties with fish health and disease arising from intensive farming; and the need for electrical power, to support continuous operation of the plant.

- b** Financial risks – including the high level of capital investment, particularly in the first two years of the Project, and the long payback period; the high costs of production; and the large volumes of production required to support the revenue levels set out in the business plan.
 - c** Market risks – including uncertain levels of demand for intensively farmed fish; the accuracy of demand projections; and price competitiveness.
 - d** Output risks – that any jobs created would be either technical, likely to be filled from outside Wales, or relatively unskilled, and that the overall cost per job would be extremely high.
 - e** Outcome risks – that profits and expertise would not stay in Wales, and that a future processing plant may not be sited locally.
 - f** Procurement risk – arising from single tender procurement from the main supplier.
- 3.8** The grant offer letter included provisions that cover shortfalls in private funding and cost escalation, which help to mitigate some of these risks. However, the risks arising from the supplier (IAT) being closely related to Selonda UK were not identified. Also, although the Welsh Government had noted that the large amount of grant funding being invested in one project represented another significant weakness, this risk was not included in the appraisal. In addition, not all the risks that were identified were adequately reflected in the scoring criteria. For example, the unit cost of project outputs, such as cost per job, is a

key element in assessing value for money. Although recognised as a project risk, the unit cost of outputs was not part of the scoring criteria used to appraise the Project.

- 3.9** In September 2003, after it had been approved, WEFO undertook a routine internal review of the Project. The review report summarised the Project's position at that time, including the application process, changes to funding, economic and technical appraisals, and also value for money considerations. The section on value for money included the following: 'This Project could be viewed as a straightforward grant support to a commercial enterprise... On those kinds of grounds this Project would represent a very low value for money score... The aim here is to support the development of a new high technology industry that could attract further inward investment... With that aim in mind the conventional measures for value for money no longer apply... a comprehensive measure of the risk has been made and the conclusion reached that the Project did represent value for money – at the time of the decision to give full approval.'

As the largest project within the grant scheme, the decision to award grant funding to Penmon Fish Farm reduced the risk that available EU funds would not be spent

- 3.10** The risk that the FIGF grant programme for 2000-2006 would be undersubscribed, and potential EU funding lost, was a consideration in the decision to approve grant funding to the Project. The initial FIGF allocation of European grant funding to Wales was £9 million. During the course of the FIGF programme, a further £7 million of European funding



was made available. At the time that WEFO was considering Selonda UK's application in respect of Penmon Fish Farm, there were concerns that the FIGF programme would be undersubscribed because of the low number and value of grant applications coming in. Any unused funds would have had to be returned to the EU at the end of the programme. A paper to the Welsh Government's Agri-Food Partnership¹³ meeting dated 10 July 2001, the month after Selonda UK made their application, included the statement '...there is a very real risk that the FIGF programme will be under subscribed. The under spending of the Fund at the end of the programme should be avoided at all costs.'

3.11 The programme monitoring report for December 2001 identified that '...nearly all of the budget...was uncommitted due to a slow start with the FIGF programme. WEFO plans to catch up on commitments in 2002 and there are project applications in the pipeline requesting grants totalling £6.8 million.'¹⁴ In the 12 months following approval of the grant for Penmon Fish Farm in July 2002, there were eight other awards, totalling £1.74 million. Eventually, £16.3 million of grants was allocated across 46 approved projects, of which the grant of £3.6 million for Penmon Fish Farm was the largest.

3.12 Within the overall 2000-2006 European Structural Funds programme, of which FIGF was a part, WEFO gave particular care to monitoring the performance of FIGF because it recognised that '...any slippage on one or two of the large projects drawing on those funds has the potential to have a

disproportionate effect'.¹⁵ The National Audit Office's report on Structural Funds of 2002 stated that WEFO was depending on '...a handful of aquaculture projects' to proceed quickly 'to avoid de-commitment of £1.4 million of grant on 31 December 2002'.¹⁶

Grant approval was subject to the general conditions of the funding scheme, which were not specific enough to reflect the Project's particular risks and technical complexity

3.13 Under the FIGF grant scheme, the private sector was required to contribute a minimum of 40 per cent of eligible expenditure, FIGF could contribute a maximum grant of 35 per cent, and a minimum of five per cent had to be provided by other public sector match funding. The Rural Assets Strategy Partnership evaluated the grant application in February 2002¹⁷ and a FIGF grant of £3.6 million was approved by WEFO in July 2002. The grant represented 35 per cent of the £10.3 million project expenditure eligible under the scheme. The grant offer letter stated that the grant awarded was calculated as the minimum necessary for the Project to succeed. Initially, additional public support would come from a £50,000 grant from Isle of Anglesey County Council and £464,000 in match funding from the Welsh Government, which had been approved by the Fisheries Policy Unit. Private finance of £6.2 million would be required to make up the balance.

¹³ Paper by the Fisheries Subgroup of the Agri-Food Partnership, prepared for the Agri-Food Partnership meeting of 10 July 2001. The partnership exercised oversight of the FIGF programme but was not involved in approving grants to individual projects.

¹⁴ National Assembly quarterly progress report on Structural Funds programmes, December 2001. The 'pipeline' projects included the £3.6 million of FIGF grant which was subsequently awarded to the Penmon Fish Farm project, in July 2002.

¹⁵ National Assembly quarterly progress report on Structural Funds programmes, March 2002

¹⁶ National Audit Office national report, *European Union Structural Funds – Maximising the Benefits for Wales*, 2002

¹⁷ The Rural Assets Strategy Partnership provided advice to WEFO on the strategic fit between the proposed project and the objectives of the funding scheme, as part of the grant application evaluation process. WEFO took the final decision on FIGF grant funding.

3.14 The grant offer letter set out the amount of the grant and the conditions attached to it, which were nearly all generic to grants awarded under the FIG scheme. One special condition relating to limits on profitability was included. This special condition was not always applied to FIG projects, particularly to smaller projects. Apart from this special condition, the conditions of the FIG grant for Penmon Fish Farm were not tailored to address the scale or technical complexity of the Project or the particular risks identified during the appraisal process. The main grant conditions were:

- a** the grant must be used for the purposes of the Project for which it is approved;
- b** for capital investment projects the proposed investment in buildings and equipment should be in accordance with the schedule of expenditure in the grant offer letter, and must be completed in full;
- c** for a five-year asset retention period, assets must be kept in good repair and used for the purposes for which the grant was given (for Penmon Fish Farm this period ran to 31 December 2013);
- d** records for all eligible expenditure must be kept for three years after final payment;
- e** the scheme must meet EC publicity requirements, and acknowledge support of the EU and the Welsh Government, for example on plaques and billboards, in publicity and information materials, and in press releases; and

f the special condition that the grant recipient must not make a profit until the fourth year of operation, and thereafter profit must be limited to a specified percentage of turnover, above which the Welsh Government would be able to recover grant equivalent to 35 per cent of the excess profit.

3.15 The 'target outputs' for the Project were expressed in the grant offer letter as an aquatic development and 30 gross jobs created. The final version of the grant offer letter, dated 30 August 2007¹⁸ states 'Specifically, grant is offered on condition that the Project delivers its aims and produces the agreed quantified targets and pattern of expenditure...' and that 'WEFO is under no obligation to pay more than 95% of the FIG grant specified until the project has been completed to its satisfaction...'.¹⁹

Annex B to the offer letter included the general conditions and the special condition (relating to profitability) of grant, and stated that grant could be withheld or repaid, wholly or in part, if:

- a** it is not used for the purposes of the Project;
- b** WEFO considers the future of the Project to be in jeopardy;
- c** any information provided in the application or in subsequent or supporting correspondence is found to be substantially incorrect or incomplete; and
- d** there is unsatisfactory progress towards completing the Project or meeting the target outputs.

¹⁸ During the project, new versions of the grant application form and grant offer letter were required because of changes in the funding arrangements, expenditure profile, completion timescale, business plan and project costs. The key outputs and technical specification remained unchanged.

¹⁹ Grant offer letter from WEFO to Selonda UK, 30 August 2007, paragraphs 2 and 7



3.16 The grant offer letter stated that the Project should be completed on the basis of the details set out in the application. However, the general descriptions of the plant, wetland and landscaping in the grant application and supporting documents were not detailed technical specifications, and the grant conditions did not bind the applicant to deliver the Project in line with their claims and assertions. In addition, the application documentation included statements about aspects of the fish farm which were not included within the approved expenditure for the Project, such as landscaping and planting. Therefore, completing these works was not a condition of the FIFG grant.

3.17 Selonda UK's ecological and environmental claims in relation to the fish farm were influential in securing grant funding for the Project because they contributed to the high score the environmental aspects received in the technical appraisal of the grant application. Including all of the significant and environmentally sensitive aspects of the fish farm within the Project, specifying them in

grant conditions and monitoring them would have reduced the likelihood of the problems that subsequently arose.

3.18 The grant conditions required all necessary permits and consents to be in place but did not require the Project to be completed in accordance with the detailed regulatory requirements. The FIFG grant application contained sections that required the applicant to demonstrate how they would comply with legal requirements in areas such as equalities. However, in common with other funding schemes, the grant offer letter did not include any general requirement for the grant recipient to comply with UK law, regulations, taxation or any standards of conduct in business. If the Welsh Government was able to develop an enforceable condition that covered such requirements, its inclusion would help to safeguard public funds used for grant-funded projects. It would also mitigate potential risks to the Welsh Government's reputation, through association with companies which did not meet the requirements of such a condition.

Fish are grown to maturity in indoor seawater tanks



Photo courtesy of Anglesey Aquaculture Ltd

Part 4 – The Welsh Government’s monitoring of progress focused insufficiently on the risks identified during the Project’s appraisal

The Welsh Government’s structures and processes for grant-funded projects did not support the effective management of complex projects

- 4.1** WEFO was established in 2000 as an executive agency of the National Assembly and in 2003 was reorganised to become a division within the Welsh Government’s Department for Economic Development and Transport. In 2013, WEFO was moved to become part of the Department of Finance and Corporate Services. WEFO was (and is) responsible for managing various European grant schemes in Wales. Within WEFO, different teams were responsible for managing aspects of FIG grants and there was a clear separation of duties between them. The Programme Management Team managed the application and appraisal; the Claims Management Team handled claims and payments; and the Monitoring and Evaluation Team managed site visits, inspections and output monitoring.
- 4.2** Welsh Government match funding approval and payments were managed separately by the Fisheries Policy Unit, which at that time was part of the Welsh Government’s Department for Environment, Planning and Countryside. To support its management of the match funding, the Fisheries Policy Unit placed reliance upon the project appraisal and financial monitoring undertaken by WEFO.
- 4.3** The Welsh Government did not have an integrated, IT-supported project management system in place and the various teams, which were not co-located, held their own paper files. Consequently, the teams undertook their functions largely in isolation from each other. In the case of Penmon Fish Farm, WEFO’s Monitoring and Evaluation Team told us that it was not aware of the project risks that had been identified by WEFO’s Programme Management Team during the Project’s appraisal.
- 4.4** In addition, Welsh Government officials have told us that effective arrangements for communication and co-ordination between the Welsh Government and external regulatory bodies, such as planning authorities and the Environment Agency, were not in place, which could have strengthened risk management and enforcement action if project monitoring had identified problems with a project. Where permits and consents are required, WEFO checks that these are in place before the project is formally approved. However, grants are not conditional upon compliance with the specific requirements of other regulatory bodies. Monitoring and enforcement of such requirements are the responsibility of the relevant bodies and WEFO does not routinely receive relevant information from them.



The main supplier contract was awarded to a related company without a competitive tendering process, and no controls to mitigate the associated risks were put in place

- 4.5** To demonstrate that good value for money is achieved from grant funding, EC requirements for the FIG grant scheme stated that EC rules should apply to procurement in respect of grant-funded projects. This requires contracts above a certain limit to be advertised in the Official Journal of the European Union (OJEU). Although commercial, private sector bodies are not covered by EC procurement rules, they are expected to use fair and open practices, including competitive tendering, when letting contracts supported by Structural Funds grants.
- 4.6** The major supplier to the Project, IAT, was part of the same group of companies (Selonda SA) as the grant recipient, Selonda UK; which also held a minority share in IAT²⁰. The value of the contract with IAT was £10.3 million, representing the entire eligible cost of the Project and including project management, design, manufacture and installation. Selonda UK awarded the contract to IAT without going out to competitive tender.
- 4.7** IAT was also the main supplier to the Bluewater Fish Farm project, in which it had a 12.5 per cent share. IAT's experience of developing the recirculation systems for the Bluewater Fish Farm project was a positive factor in WEFO's appraisal of the level of Project delivery risk in relation to the Penmon Fish Farm project, which utilised the same technology although on a much larger scale.
- 4.8** Selonda UK identified in its grant application that IAT would be the only supplier. Following a financial controls check in April 2003, WEFO raised concerns in relation to compliance with EC procurement requirements. To address such concerns, in July 2002 Selonda UK had commissioned a report from an independent consultant to justify its assertion that a single tender was appropriate because of the technically complex nature of the Project. WEFO accepted the report's conclusion that only IAT could provide the specialist technical expertise required, thereby making a competitive tendering process unnecessary. A competitive process had not been followed for awarding the Bluewater Fish Farm contract to IAT for the same reason. The absence of competitive tendering raises the risks of a lack of transparency and poor value for money, even if the supplier is an unrelated company. The likelihood of these risks increases where the supplier is a related company.
- 4.9** The controls exercised by WEFO reflected the requirements of the scheme in place at the time, but they provided little assurance in relation to compliance with specification, value for money, price manipulation, excessive profits and financial regularity or fraud risks. These risks increase where there is only one contract covering all eligible expenditure, and where the contractor is a related company. The relationship between Selonda UK, as the grant recipient, and IAT, as the contractor, was recognised during the Project appraisal. However, no specific conditions of grant or controls to mitigate the risks arising from procurement by single tender from a related company were put in place. Checks by WEFO or by the grant recipient's external auditors on payments did not extend beyond IAT's invoices to Selonda UK. Transactions between IAT and its suppliers were not checked, and IAT's invoices to Selonda UK did not include a detailed breakdown of what the invoices covered.

²⁰ Selonda SA's Annual Report 2004 identifies relationships between its subsidiaries, including Selonda UK's ownership of 25 per cent of IAT Ltd.

WEFO's verification of grant claims focused primarily on checking that Project expenditure figures were accurate and as agreed, rather than on risk management or value for money

4.10 WEFO has responsibility, on behalf of the Welsh Government, for managing grant payments to the recipient and verifying that project expenditure is incurred in accordance with the agreed profile and the purposes for which the grant was made. The Project was funded under the 2000-2006 FIG scheme, which closed in 2009. The Project was subject to the inspection regime that applied to the 2000-2006 EU Structural Funding programmes, whereby all grant claims were subject to basic checking by WEFO staff to ensure that they were complete and not obviously misstated. WEFO's checks in relation to payment of FIG grant instalments focused on eligibility of the expenditure funded by the grant, provision of private match funding, compliance with EU procurement regulations, and financial completeness (that the full amount of grant agreed was claimed during the project).

4.11 WEFO had three key mechanisms to confirm that projects complied fully with regulations and that the correct amount of grant was being claimed:

- a** an annual audit of each project by an independent reporting accountant, engaged by the grant recipient, to confirm that expenditure claimed during the period was eligible, valid and correctly stated;

- b** monitoring visits to a sample of projects to confirm that the grant recipient had adequate financial and management controls in place, and (as required by EU regulations) to confirm that expenditure claimed related to goods and services delivered;²¹ and
- c** audits of a sample of projects, by officials of the Welsh Government on behalf of the EC, to check that the projects comply with EU regulations on eligibility of activities, match funding, expenditure, publicity and procurement.

4.12 These controls focused on the risk of claims containing financial error or on identifying non-compliance with EU regulations. Such errors or non-compliance would have resulted in the claw back of grant if discovered by the EC's own auditors. WEFO's instructions for reporting accountants (responsible for providing audit certificates to support grant claims) did include a test to confirm that 'the project carried out is the same as that originally approved', but there was no further guidance on the extent of the work needed to confirm whether or not this condition was met.

4.13 Grant recipients were expected to submit quarterly grant claims against eligible project expenditure incurred, in line with a profile agreed and specified in the grant offer. WEFO's FIG grant claims verification was based on certification, usually by the grant recipient's external auditors, that the eligible expenditure had been incurred. A grant recipient would submit a claim form to WEFO identifying the amounts of eligible expenditure incurred. WEFO would check that the claims were under the headings of eligible expenditure, within the amounts agreed and fitted the expected profile of expenditure. Then, the grant recipient's appointed auditors

²¹ At present, within WEFO, these checks are financially focused but in order to strengthen the evaluation and monitoring of projects' technical aspects, better access to technical expertise is being established.



would match invoices from contractors and suppliers to payments in bank statements, and issue an annual audit certificate. The audit certificate was intended to give assurance that claims reflected actual expenditure incurred, within amounts and categories set out in the grant offer. The verification of grant claims and audit certification did not involve specific checks that goods and services had been delivered or physical assets had been constructed, nor that projects were being completed in line with the agreed descriptions in the application and supporting documents.

- 4.14** WEFO officials made quarterly site visits to monitor progress with the fish farm project. The purpose of the site visits was to:
- a** check that the project was carried out in accordance with the approval letter;
 - b** check that management and financial systems were sound;
 - c** verify the eligibility of expenditure and confirm the outputs achieved;
 - d** check compliance with contract procurement procedures;
 - e** check that publicity had been undertaken in accordance with EC guidelines; and
 - f** check that any variations to the Project were necessary and were within the grant scheme's requirements.²²

4.15 These visits identified some problems with financial records keeping; the absence of an equalities policy; and that disabled access to the facility had not been constructed. Visits also identified that progress with the Project was behind schedule and WEFO became concerned that the full amount of grant may not be claimed within the period of the funding scheme. In response to slow progress against the agreed expenditure and claim profile, the frequency of monitoring visits increased from quarterly to monthly.

4.16 WEFO project files include documents that record discussions between Selonda UK and WEFO officials during site visits about filtration trials and problems with the power supply. There was also frequent correspondence between Selonda UK and WEFO in relation to project progress, funding arrangements, difficulties during construction and testing of the plant and artificial wetland, and problems with the power supply. During the technical appraisal of the grant application, risks were identified in relation to recirculation technology, the saline wetland and the plant's demand for electrical power. However, these risks were not reflected specifically in grant conditions. The WEFO officials undertaking the site visits were not aware of the risks identified during technical appraisal of the application; and their focus was on the financial checks required by the grant scheme, rather than risk management or value for money.

²² These functions were spread amongst different teams within WEFO.

WEFO agreed variations to the Project's funding sources and completion timescale and was responsible for monitoring progress, but checking compliance with specific regulatory requirements was not within its remit

- 4.17** Notifying WEFO of substantial changes to the Project is a requirement within the grant offer letter. Where a significant variation to the Project was proposed, in relation to funding, completion date, approved costs and claims, a revised grant application was required for approval.
- 4.18** Between June 2001 and August 2007 Selonda UK submitted seven versions of the grant application form. In September 2002 the Company had advised WEFO that initial plans for the Project to produce halibut would be changed to the production of sea bass. In February 2005 Selonda UK submitted a revised business plan to WEFO, reflecting the change from the farming of halibut to sea bass and providing updated financial projections showing the Project's increased costs, changes to financing arrangements and improved cash flow arising from the shorter growing cycle of sea bass compared with halibut (12 months instead of 36 months).
- 4.19** WEFO's approach is to work with grant recipients wherever possible to address any problems which arise during project delivery. In the case of the Penmon Fish Farm, to avoid precipitating Project failure and the potential loss of public and private investment in the plant, WEFO approved changes to the Project's completion date, claims schedule,

funding sources and costs, which were reflected in changes to the grant application and approval letter. WEFO also agreed the change from producing halibut to sea bass. However, the main text in the application form and supporting documents remained unchanged; including descriptions of the plant, wetland and landscaping and also references to producing halibut. The Project's objectives were also unchanged.

- 4.20** The Project's objectives were described as 'target outputs' in the grant offer letter. They were the delivery of an aquaculture development (a fish farm) and 30 gross jobs. The Welsh Government told us that WEFO did not usually regard achieving target outputs as a 'condition' of grant funding and so would not normally recover grant if, for example, the target number of jobs was not achieved. Where projects have reached a late stage before problems come to light, WEFO's enforcement options are limited. They can withhold payment of existing claims, stop further payments or, in serious cases where the recipient has not acted in good faith or has been fraudulent, they can cancel the project altogether and seek repayment of the grant. WEFO is satisfied that the fish farm achieved its target outputs and that the essential elements of the Project were delivered.
- 4.21** Most projects funded under the 2000-2006 EU Structural Funds programmes received grants of less than £1 million. The relatively small amounts of grant funding meant that projects were not usually tested in any depth against their specifications. WEFO's focus was on ensuring compliance with the EU's regulatory framework, which is demanding, that EU spending targets were met and that outputs were fully recorded and on target. The grant offer letter set out categories of expenditure eligible for funding, such as 'power supply' and 'wetlands', but on their own



the categories were too broad to provide a basis for monitoring completion according to the descriptions contained in the application and supporting documents.

4.22 Where variations arose within categories of approved expenditure, WEFO did not regard these as significant enough to require a revised application and approval and a more informal approach was adopted. Letters, emails and notes from site visits show that WEFO was kept informed when tests and operational use of the recirculation and filtration systems revealed problems. Selonda UK was able to modify these systems and to supplement the reed beds with filtration sacks but WEFO did not formally document approvals to these changes.

4.23 Monitoring and enforcing compliance with the regulatory requirements of the planning authority and Environment Agency are responsibilities of the relevant bodies and does not form part of grant monitoring. Because of the fish farm's location in an area of outstanding natural beauty, various concerns were raised during the consultation phase of the process for obtaining planning permission. These included concerns about electricity supply, visual impact, noise, odours and pollution. The planning consent required Selonda UK to provide detailed plans for landscaping and of the coastal embankment, which was to be undertaken in accordance with the plans. To date, this work, which was not part of the grant-funded Project, has not been completed. The planning consent for the fish farm noted that a separate consent would be necessary for the electricity supply but this was not made a condition of the consent. No specific conditions were attached to planning consent to address potential issues of noise or nuisance, despite the industrial scale of the fish farm operation and its location in a conservation area.

4.24 The Environment Agency permits for the fish farm specified clear requirements to address risks of pollution. These included aspects of the intake and outflow pipe construction, discharge monitoring requirements and permitted levels of pollutants. Evidence given in court during the Environment Agency's successful prosecution of Selonda UK established that key elements of the fish farm, including the outflow pipe, wetland reed beds and filtration system, were not completed as specified or were not operating effectively and these factors, along with failures to meet the specific requirements of the discharge permit, had contributed to the pollution.

Part 5 – The funding regime for European grants has been strengthened in recent years and, as a result, arrangements for managing complex projects have improved

Some of the weaknesses we have identified in the Welsh Government's management of the public investment in Penmon Fish Farm illustrate some of the more widespread shortcomings in grants management that existed at the time

- 5.1** Grant making by public bodies is covered by administrative law, which governs the actions of public bodies in exercising their functions. A grant represents a gift or donation, and is less enforceable than a contract. A funder has no right to receive anything in return for a grant, but the grant agreement may include terms and conditions specifying how the grant is to be spent.
- 5.2** In 2002 the National Audit Office examined the management of grants in Wales funded by the EU.²³ The report concluded that WEFO's project appraisal procedures were basically sound, but could be made more sophisticated in terms of assessing project need, added value, risk and value for money. The report recommended that WEFO should do more to:
- a** assess added value (the additional benefits offered by projects) by focusing on areas of risk and ensuring that all parties are aware of what is required of them;
 - b** re-examine its arrangements for satisfying itself about the value for money of projects, including requiring improvements in the adequacy of the information in applications on which judgements are made;
 - c** ensure applicants identify the risks in projects and how they will be managed; and
 - d** incorporate a more detailed assessment of project need and quality into the criteria for selecting projects.
- 5.3** Many of the shortcomings identified by the National Audit Office can be found in the Project. The National Audit Office report also identified weaknesses in WEFO's assessment of project outputs, including cost per job. The report noted that Wales compared unfavourably against other areas of the UK which benefit from EU Structural Funds, such as Cornwall, where indicators, such as unit costs and job creation levels, were used more extensively in assessing projects.
- 5.4** A follow-up report by the National Audit Office in 2004 identified some improvements in WEFO's management of grants. However, weaknesses identified in subsequent reports by the Wales Audit Office suggest that the improvements were not sufficient to address all of the problems which arose with the public funding of Penmon Fish Farm.

²³ National Audit Office report, *European Union Structural Funds – Maximising the Benefits for Wales*, 2002

²⁴ *Grants Management in Wales*, November 2011



5.5 In 2011 the Wales Audit Office examined grants management in Wales.²⁴ The report drew on the findings from 18 reports on grant-related matters published by the Wales Audit Office between 2005 and 2011. The report found that the costs of administering grants in Wales were high and identified common weaknesses in the management of grants, in learning from experience, and in addressing the poor performance of grant recipients in delivering grant-funded projects. In particular, the report found:

- a** weaknesses in the ways in which grant funders defined the objectives of their support for projects;
- b** failures to establish, as part of the conditions of grant, clear quality standards in respect of how projects should be delivered; and
- c** failures to link clearly defined outcome objectives with a clear understanding as to how the programme or Project will deliver those objectives and a robust analysis of the resources needed.

5.6 In 2012, the Wales Audit Office's report on the Welsh Government's relationship with the All Wales Ethnic Minority Association (AWEMA)²⁵ highlighted continuing weaknesses in grants management, including in relation to WEFO. To address these, the report recommended that:

- a** the Welsh Government should establish due diligence protocols to be built into processes for awarding and monitoring grant funding, proportionate to the scale of funding and type of recipient body;

- b** WEFO should ensure all project officers are aware of the purpose and importance of monitoring and verifying that projects are proceeding satisfactorily and delivering intended outcomes; and
- c** WEFO should review all special conditions and take any necessary follow-up action promptly.

5.7 At present, the Welsh Government is responding to these issues, particularly in relation to grant funding of public organisations and third sector bodies. The National Assembly's Public Accounts Committee published its own interim report on grants management in August 2012.

The funding regime for European-funded grants has been strengthened

5.8 There have been significant changes in procedures for the current (2007-2013) programming period, although the basic purpose and structure of controls remain unchanged. The FIFG has been replaced by the European Fisheries Fund and is administered by a single unit (currently known as the Scheme Management Unit), which is within the Welsh Government but outside WEFO. WEFO retains responsibility for the larger European Regional Development Fund (ERDF) and the European Social Fund (ESF).

²⁵ *The Welsh Government's relationship with the All Wales Ethnic Minority Association*, Wales Audit Office, October 2012

5.9 We examined European Fisheries Fund procedures which have been tightened in a several respects:

- a** Each claim for grant payment must be accompanied by detailed schedules showing how the money has been spent and copies of all relevant supplier invoices. Grant claimants in the 2000-2006 programmes did not need to supply any schedules or invoices to support their claims and WEFO used to rely on certifying auditors to verify claims.
- b** All grant claims are subject to an inspection before the claim is paid. The inspection covers financial aspects of the claim and includes a physical inspection to check that goods and/or services have been delivered in accordance with the claim. Inspections are carried out by fisheries enforcement officers who are part of the recently created Fisheries and Marine Division. In contrast, for the 2000-2006 programmes WEFO undertook monitoring visits for a sample of projects and did not necessarily physically inspect the work done. Monitoring officers covered a wide range of Structural Funds activity and did not necessarily have experience or expertise in fisheries work.
- c** Every project is subject to a full technical inspection before the final grant payment is made. The aim is to confirm that the project has been delivered in line with the project application and will meet the project's original aims and objectives. The content of the inspection will depend on the nature of the project, and the Scheme Management Unit has access to technical specialists in the Welsh Government, such as surveyors or engineers, if required.

There was no requirement for such a technical inspection in the 2000-2006 programmes. Each project's external auditor was required to check that the project was being delivered as approved, but it is highly unlikely that this would have involved a detailed assessment against the original application or any approved changes.

- d** The Scheme Management Unit's procedures for requesting, agreeing and documenting variations to European Fisheries Fund projects in progress have been strengthened compared to the procedures used for the 2000-2006 FIG programme. A grant recipient is required to submit a formal Project Variation Form which gives clear details of the most recent approved costs, the proposed changes and the rationale for them. This information is then subject to an appropriate appraisal, which could include updated financial and technical assessments, before progressing to the approvals processes. If approved, a revised grant offer letter is issued. These variation procedures are followed where costs are more or less than originally forecast or where there are changes to elements of the project as originally approved.

5.10 These changes, if fully implemented, will strengthen controls significantly compared with the 2000-2006 programming round. The extent and depth of monitoring is substantially greater, and the physical and technical inspections make it more likely that any significant deviations from the agreed project plan would be picked up at an early stage, although the extent of the technical checks will depend on the judgement of the inspector in any given case.



- 5.11** The Welsh Government considers that the revised administrative arrangements, under which the Welsh European Fisheries Fund programme is managed by a single unit, has a number of benefits that would reduce the risk of important issues not being detected and acted on in a timely fashion. Monitoring and payments staff work solely on fisheries projects and therefore develop significant experience and expertise, and the small size of the unit relative to WEFO means that the links between these staff are closer than they were.
- 5.12** The risks arising from Selonda UK contracting with a related company to deliver most of the capital works would not be addressed by the standard questions in the inspection checklists used for the current fisheries programme. Risks such as these, which relate to the particular circumstances of a project, should be identified and mitigated through special conditions in the offer letter and related monitoring. A special condition highlights the importance of a particular issue for both the grant recipient and the Welsh Government's monitoring staff, and helps ensure that the issue is managed robustly. WEFO now uses special conditions frequently to ensure that project-specific risks are identified and monitored through regular project reviews. The Scheme Management Unit makes less use of special conditions than WEFO, but it does require those which are set to be monitored as part of the inspection process.
- 5.13** To facilitate more robust monitoring of project expenditure in relation to clearer, more specific requirements, categories of approved costs are more narrowly defined in grant offer letters in the current European Fisheries Fund programme than they were for the FIGG programme, which included the grant to the fish farm. Now, more categories of approved expenditure are likely to be specified and a breakdown of costs within categories is also included.
- 5.14** Overall, the Welsh Government has progressively strengthened its arrangements for managing grant funding. Improvements made since the Project mean that it is more likely now that significant risks would be identified during the project appraisal and evaluation process, that special conditions would be used and monitored to address risks which are identified, and that more robust controls would identify problems as they arise and lead to timely enforcement action, if appropriate.

Appendix 1 – Sources of public funding for Penmon Fish Farm

The following public funding streams have been identified:

Public funding source	£
FIFG grant	£3,601,454
Welsh Government match funding for FIFG grant	£1,514,494
Agri-Food Development Scheme: Project Marketing and Branding – 2009	£2,920
European Fisheries Fund grant (fish sorting and stunning plant) – 2009	£43,431
Welsh Government match funding for European Fisheries Fund grant – 2009	£31,000
Welsh Government revenue support for fish food and oxygen – 2011	£40,000
Welsh Government funding for power supply – 2011	£27,000
Total	£5,260,299



Appendix 2 – Penmon Fish Farm – Project timeline

Key dates	Grant application and approval	Financing	Project progress
2001			
June	FIFG grant application submitted to WEFO, supported by business plan and environmental statement.	Eligible Project costs £10,300,755. Private £6,180,453. Application for FIFG grant of £4,120,302.	Forecast completion April 2003.
July	WEFO technical assessment results in highest rating score. Revised FIFG application form reflecting changes to costs and funding.	Eligible Project costs £10,289,870. Private £6,172,922. Welsh Government match funding £514,493. Application for FIFG grant of £3,601,454.	
2002			
February	Rural Assets Strategy Partnership evaluate application.	Eligible Project costs £10,289,870. Private £6,173,922. Welsh Government match funding £514,494. FIFG grant £3,601,454.	Planning consent granted by Isle of Anglesey County Council.
March	Revised FIFG application form, reflecting changes to costs, funding and completion date.	Eligible Project costs £10,289,870. Private £6,173,922. Welsh Government match funding £464,496. Application for Anglesey County Council grant of £50,000. Application for FIFG grant of £3,601,456.	Forecast completion March 2004.

Key dates	Grant application and approval	Financing	Project progress
2002			
June			Environment Agency approve permit to discharge treated waste into sea.
July	WEFO approve FIGG grant and issue grant offer letter (dated 25 June) to Selonda UK.	Eligible Project costs £10,289,870. Private £6,173,922. Welsh Government match funding £464,494. Application for Anglesey County Council grant of £50,000. Approval for FIGG grant £3,601,454.	Forecast completion March 2004.
August		Icelandic partners (FISKEY) withdraw £3 million of private funding.	
September			Selonda UK notify WEFO of switch from halibut to sea bass.
2003			
January		Welsh Government Ministerial decision to increase match funding to £1.51 million.	
February		Anglesey County Council refuse application for £50,000 of match funding grant support because the funding for this originates from EU.	



Key dates	Grant application and approval	Financing	Project progress
2003			
March	Revised FIG application form reflecting changes to project funding.	Private funding decreased from £4,973,922 to £3,944,936. Welsh Government match funding increased from £464,494 to £1,543,481.	
April			Site visit identifies no physical works done on-site.
May	WEFO identify procurement risks with single tender procurement from related company as main contractor.		
June	Revised FIG application form reflecting changes to project funding.	Eligible Project costs £10,289,870. Private funding increased to £5,144,935. Welsh Government match funding £1,543,481. FIG grant £3,601,454.	Forecast completion June 2004.
September	Project review by WEFO highlights risks, justifications for proceeding with project, value for money concerns and high cost per job. Technical appraisals and concerns are summarised.	Project review recognises major new power supply costing £1,316,000 is needed to 'build the Farm at Penmon and leave capacity for future expansion'.	WEFO review notes that IAT has relocated to Wales bringing 20 jobs.

Key dates	Grant application and approval	Financing	Project progress
2004			
June			Scheduled grant claim not submitted by Selonda UK to WEFO for payment as project running behind plan.
December			Selonda SA write to WEFO explaining delays to the project arising from problems with the recirculation technology in use in the Bluewater Farm requiring changes to the design of recirculation systems for the Penmon Plant.
2005			
February	Selonda UK write to WEFO enclosing a revised business plan reflecting change from halibut to sea bass in financial projections although the text in the application form continues to refer to halibut.	Grant funding unchanged.	
May			WEFO writes to Selonda UK expressing concerns about project progress, threatening to cancel project and reclaim grant.
September			Selonda UK write to WEFO identifying completion date of December 2006, which requires re-approval.



Key dates	Grant application and approval	Financing	Project progress
2006			
March		Selonda UK write to Welsh Government Fisheries Policy Unit requesting an exceptional payment of £622,500 from Welsh Government match funding to meet additional deposits requested by contractors against construction costs. The request is approved and payment is made.	
June			During a site visit Selonda informs WEFO of expected completion by March 2007. Delays are due to improvements required to the recirculation system specification. There are also difficulties reaching agreements with neighbouring landowners about the electricity supply. Site visit notes that the wetland is processing waste from the Bluewater Flatfish Farm.
December			Site visit notes construction of tanks and buildings is progressing. Costs escalating due to increases in construction costs, technical requirements and electricity supply issues.

Key dates	Grant application and approval	Financing	Project progress
2007			
June	Selonda UK writes to WEFO expressing intention of siting a fish processing plant on Anglesey once fish farm production reaches the required volumes.	Selonda notifies WEFO that costs of establishing power supply increased to £1,035,000.	WEFO site visit identifies buildings nearing completion. System test on installed tanks expected in August 2007.
July			Grant claim form states eight jobs created.
August	Revised FIGG application form and offer letter due to increased project spend to £11,978,803. Private funding increased to fund ineligible expenditure. FIGG grant funding and Welsh Government match funding unchanged.	Eligible Project cost £10,289,870. Private £6,862,855. Welsh Government match funding £1,514,494. Approved FIGG grant of £3,601,454.	95 per cent of total FIGG grant paid to date. Planned completion May 2008. Total forecast Project cost, including ineligible expenditure £11,978,803.
October			Selonda UK informs WEFO that power supply issues involving agreements with landowners and construction costs are likely to extend beyond Project completion date of August 2008.



Key dates	Grant application and approval	Financing	Project progress
2008			
August	Revised FIG application form submitted and agreed. Form text unchanged and still refers to halibut.	Costs unchanged from August 2007.	
October		On 20 October WEFO agrees that all ineligible expenditure associated with the Project will not be incurred by the end date of 31 December 2008. This approval removed ineligible costs associated with completing the power line from the Project.	Formal agreement by letter from WEFO to Selonda UK of revised FIG Project completion date 31 December 2008. Final claim to be received by end of February 2009.
December			Project completion date Grant claim form states 17 jobs created.

Key dates	Grant application and approval	Financing	Project progress
2009			
January			Penmon Fish Farm begins operating. Tanks stocked with fish fry.
February	Final FIFG claim form submitted. All eligible expenditure claimed.	Email from Selonda UK to WEFO identifies that cost of wetland has risen above the forecast cost of £513,000, approved as eligible expenditure, to £600,046. The ineligible additional costs are to be met by Selonda UK from other sources.	
March	Selonda UK applies for a grant under the Welsh Government's Agri-Food Development Scheme: Project Marketing and Branding. Agri-Food grant is approved.	Project cost £5,840. Grant £2,920. Final FIFG grant payment made (£180,073) to total £3,601,454.	Selonda UK applies for planning consent for mains power supply, but application is withdrawn before being considered by the council.
July			WEFO monitoring identifies 28 jobs.
August	Selonda UK apply for European Fisheries Fund grant for fish sorting and killing plant.	Project cost £124,088. Grant £43,431.	Planned European Fisheries Fund project completion July 2010. WEFO monitoring identifies 33 jobs.
November	Welsh Government Fisheries Unit approves European Fisheries Fund grant and match funding.	Project cost £124,088. Grant £43,431. Welsh Government match funding £32,022.	



Key dates	Grant application and approval	Financing	Project progress
2009			
December			Bluewater Flatfish Farm, which had been operating at below its planned capacity due to technical problems with the recirculation and filtration systems, ceased operating. The facility was then used for packing fish from Penmon Fish Farm.
2010			
April			Isle of Anglesey County Council serves noise abatement notice on Selonda UK for low-frequency noise arising from diesel generators. Quieter generators are brought in to reduce noise.
August			Environment Agency investigates a chemical spillage and discharges of effluent into the sea.
2011			
August	Welsh Government funding to Selonda UK to develop a sustainable power supply approved.	£27,000 grant to Selonda UK for power supply, payment is made direct to the power company. Total project cost is £85,000 with Selonda UK providing £58,000.	Power supply project due for completion in March 2012.

Key dates	Grant application and approval	Financing	Project progress
2011			
October			Selonda UK pleads guilty to allowing trade effluent and chemical waste to pollute the natural environment.
November		Selonda UK experience cash flow problems. The Welsh Government provides interim assistance of £40,000 by purchasing supplies of fish food and oxygen.	
2012			
January		Selonda UK liquidated and assets sold for £1.2 million. New operator is Anglesey Aquaculture Ltd (AAL).	
May			New operator, Anglesey Aquaculture Ltd, completes the additional project to improve the existing power supply to the quarry.

Archwilydd Cyffredinol Cymru
Auditor General for Wales

Public funding of the Cywain Centre, Bala



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU



This report has been prepared and presented to the National Assembly under the Government of Wales Acts 1998 and 2006.

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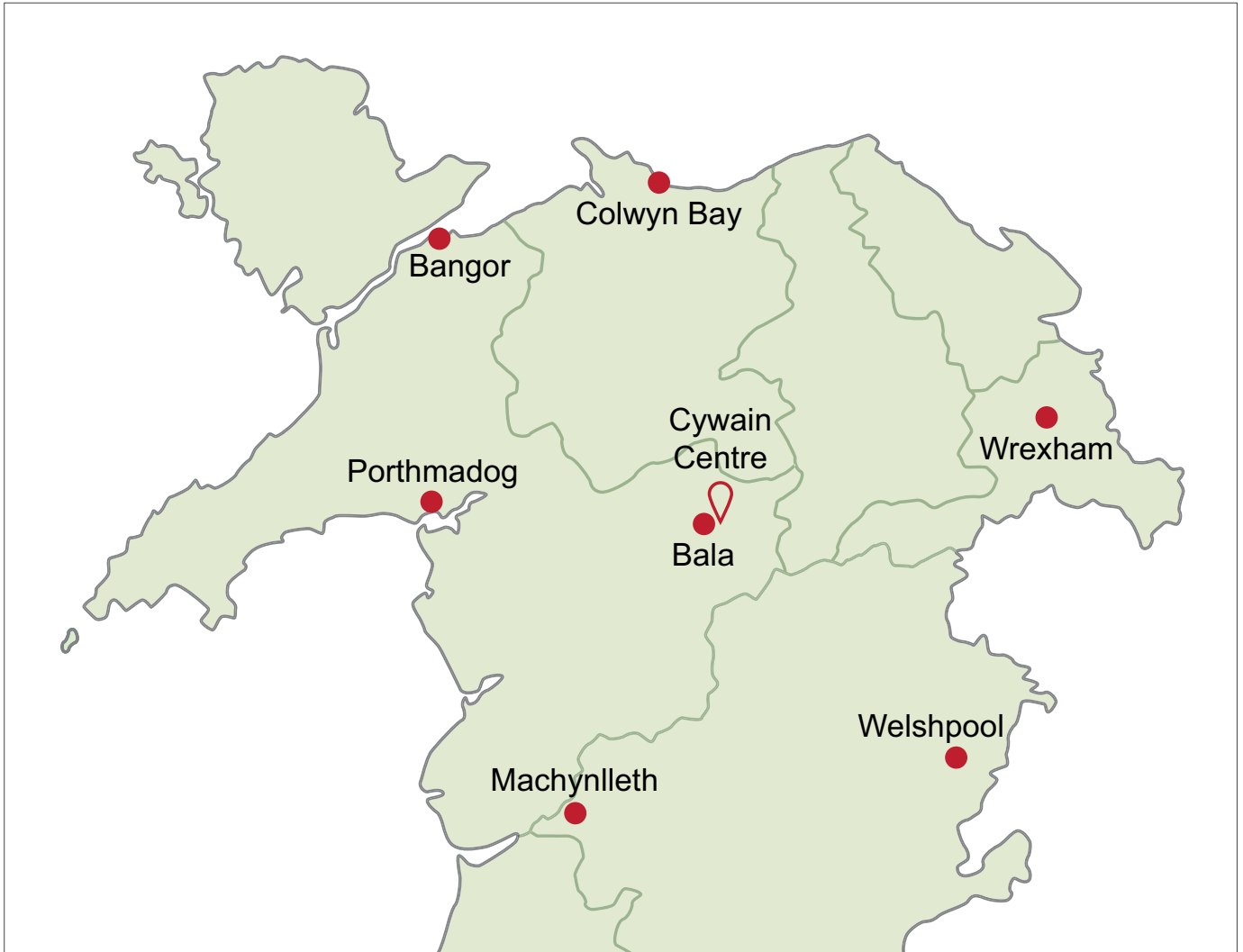
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Location of the Cywain Centre, Bala



Summary

- 1 The Cywain Centre (the Centre) opened for business as a heritage, rural life and sculpture centre in 2008. The project was developed by Antur Penllyn, a community regeneration company set up in 1989 to regenerate the Bala and Penllyn area. The Centre, which was outside the town of Bala, was intended to hold events and exhibitions on agricultural methods, provide training and education in rural skills, and exhibit modern artworks. It was also to operate a café and a small retail area, and offer venue hire for meetings and events.
- 2 The Centre is situated on land owned by the Rhiwlas Estate, with the land secured by Antur Penllyn under a leasehold agreement. The project was delivered in two phases; the first involved creating the main building and cafe, with the second phase involving the development of office space, an exhibition area and an amphitheatre, and the provision of sculptures and artworks. Antur Penllyn anticipated that the project would result in seven full-time and four seasonal jobs, and estimated that the facilities would attract 25,000 visitors in its first full year of operation, rising to 40,000 by year five. Entrance fees were planned in year one to be £5 per adult and £2.50 per child.
- 3 The total costs to the public sector were originally estimated to be £2.2 million. By the end of the project the actual costs to the public sector had risen to more than £3.4 million. The Welsh European Funding Office (WEFO), through its 2000-2006 European Structural Funds programme, was the largest source of funds. The WEFO grant accounted for 60 per cent of the total public funding of the Centre. Other major sources of funding were the Welsh Government's Pathways to Prosperity grant scheme and its Community Facilities and Activities Programme; the former Welsh Development Agency; the Arts Council of Wales; and the Wales Tourist Board (which is now known as Visit Wales). [Appendix 1](#) provides further details of the Centre's funding.
- 4 The Centre opened its doors to the public in April 2008, following completion of the first phase. Twenty-one months later, in January 2010, Antur Penllyn informed WEFO that the Centre was about to close. Although the Centre subsequently remained open, due to volunteer support, it finally closed in September 2011. Antur Penllyn's accounts show a loss in two of the last three operating years, with an operating loss of £12,182 in its final year. However, the accounts for these three years included grant income to cover revenue costs and if these are excluded, to show the underlying profitability of the project, then losses would have been made in all three years totalling £83,314.

- 5 In January 2013, Antur Penllyn issued a press release advising that, in accordance with the conditions of the lease, the building had been returned to the landlord on 1 October 2012. The press release also stated that Antur Penllyn's term had come to an end, and that its assets would be transferred to an institution in the Bala and Penllyn area that had the same aims.
- 6 The Auditor General received correspondence from the chair of the Public Accounts Committee in January 2013 expressing concerns about the value for money the Welsh Government had secured from its public investment in the Centre. Following an initial review, the Auditor General decided in May 2013 to undertake a full investigation into the public funding of the Centre.
- 7 The investigation set out to answer the question: **'Did the decisions made by the Welsh public sector, in respect of the funding and subsequent closure of the Cywain Centre, provide good value for money?'** This report was prepared by staff of the Wales Audit Office on behalf of the Auditor General. The methodology used in the investigation is described in [Appendix 2](#), and a timeline of key events is at [Appendix 3](#).
- 8 **Overall, we concluded that the public funding of the Centre did not provide value for money. All funders had recognised, to varying degrees, the unsupported and unrealistic assumptions that underpinned the business case for the Centre. However, they approved grant funding without putting in place fully effective measures to mitigate and manage the risks to the project they had identified.**
In particular:
- a the project was always likely to fail because of flawed income assumptions and a lack of clarity over what the Centre was meant to offer, both of which were not adequately challenged by funders;
 - b funders did not identify and address all of the key risks and placed too much emphasis on the potential benefits of the project, and collaboration between funders was inadequate to support effective decision making;
 - c although most of the grant conditions that were set were followed up, monitoring of the Centre's operations was inadequate and WEFO invested further public money without gaining any assurance about the Centre's financial viability; and
 - d all funders were slow to respond to the threat of, and actual, closure of the Centre and to protect the public's interests in the assets.

Recommendations

- 9 This report follows other examinations by the Auditor General in recent years into the management of grants-funded schemes.¹ These reports have identified significant changes in procedures in recent years, which should make it less likely that the mistakes evident in the funding of the Centre will be repeated. For example, WEFO has strengthened its controls over the 2007-2013 European Union Structural Funds programmes by:
- a having far fewer, larger projects – around 280 compared with more than 3,000 in the previous programming round – which has enabled WEFO to take a more proactive approach to monitoring projects; and
 - b each project now having a nominated WEFO Project Development Officer who undertakes the project appraisal and is subsequently responsible for monitoring the project, which should include regular progress meetings and occasional site visits.
- 10 The recommendations in the Auditor General's recent reports and those of the Public Accounts Committee address a number of the weaknesses in the public funding of the Centre. In addition to reinforcing the recommendations of previous reports, we make the following two recommendations:
- R1 The extent to which different funders identified risks with the project proposal varied, and, although some communication between them took place, this was not as comprehensive as it could have been. **We recommend that the Welsh Government should take steps to ensure that all funders are fully aware of the risks when assessing individual projects, through for example requiring all project assessments to be shared between funders or by having one financial appraisal undertaken on behalf of all funders.**
 - R2 Funders responded to the threat and actual closure of the Centre in a slow and uncoordinated way. In part, this reflected a view that funders did not need to take any further action once the asset retention period had passed. However, funders should have a continued responsibility beyond the asset retention period to maximise the chance that public money results in some ongoing public benefit. **We recommend that, when a project is known to be in severe difficulties and is approaching or is past the asset retention period, the Welsh Government should take urgent steps to protect the public's interests in the assets.**

¹ *Grants Management in Wales (2011); The Welsh Government's relationship with the All Wales Ethnic Minority Association (2012); and Public funding of Penmon Fish Farm (2013)*. Later in 2014, the Auditor General will also publish a report on *European Structural Funds 2007-2013*.

Part 1

The project was always likely to fail because of flawed income assumptions and a lack of clarity over what the Centre was meant to offer, both of which were not adequately challenged by funders

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Decisions to provide grant funding were based on highly flawed assumptions, particularly with regard to projected income levels

- 1.1 The business case for the Cywain Centre project, which was first developed in 2003, estimated that the project would attract 25,000 visitors in its first year rising to 40,000 in year five, representing a 60 per cent increase in visitors over the four-year period. However, these estimates were highly unreliable for a number of reasons. In particular:
 - a Antur Penllyn had based its estimates on the number of visitors using the Bala Lake Railway, a nearby successful attraction, although Visit Wales statistics² show that since 2003 the railway had attracted around 20,000 visitors a year; and
 - b the estimates also took into account estimated visitor numbers from a study in 2000 that examined the feasibility of establishing a sheepdog trialling centre on the site, which would have been a very different attraction from the heritage, rural life and sculpture centre that was established in 2008.
- 1.2 The projected visitor numbers were very ambitious, and Visit Wales figures show that it is highly unusual for visitor numbers to increase year on year to the extent projected by Antur Penllyn. Visit Wales data lists 64 tourist attractions in North Wales in 2003. To meet its forecast of visitor numbers, the Centre would have had to be the 30th most popular attraction in year one and the 24th most popular by year 5.
- 1.3 The proposed entrance fees were also comparatively high. The Centre's business case was based on an entrance fee of £5 per adult and £2.50 per child, which compared to the average entrance fee reported by Visit Wales, across all tourist attractions in Wales that charged a fee in 2003, of £3.70 for adults and £2.21 for children³. In 2003, only around one-fifth of all attractions charged £5.00 and over for adults. The Centre's business case also assumed that entrance fees would increase to £6 per adult and £3 per child from year four onwards, a 20 per cent increase. Visit Wales reported that between 2000 and 2003 average admission charges across Wales had increased by around 14 per cent.

² Annual visitor numbers to tourist attractions have been published by Visit Wales since 2003.

³ Entrance to the seven museums comprising Amgueddfa Cymru – National Museum Wales' Museums – has been free since 2001.

- 1.4 The business case had projected a relatively high level of catering income from the Centre's café. It assumed that 25 per cent of the 25,000 visitors would each spend £3 in the Centre's first year of operation, which equates to average revenue of £0.75 per visitor. Visit Wales data shows that in 2003 the average visitor catering income across all attractions was £0.53 per visitor. The income from the Centre's café was projected to increase from £18,750 in the first year to £72,000 by year five, as a result of the projected increase in visitor numbers and assumptions that a larger proportion of visitors would use the café and that each customer would spend more per visit.⁴
- 1.5 The Centre's projected income also depended on hiring out a room for conferences or training events. The business case envisaged the room being hired on 100 occasions in the first year, rising to 140 sessions in year four. The room hire fees were based on £50 or £84 per session, depending upon whether equipment was required for the meeting. The room hire fees were expected to increase to £75 or £120 per session in year four. There was no clear rationale behind these assumptions, which appear to be very ambitious given the Centre's location and the size of the local community on which the Centre would be able to draw.
- 1.6 Other budgeting information within the business case was also weak. For example, whilst income was projected to increase significantly over the five-year planning period, estimates of annual expenditure over the same period remained constant.
- 1.7 Even when based on these optimistic, yet unrealistic, assumptions about income and expenditure, the business case identified a shortfall in operating income in the first year of £21,550. The forecast then was for the Centre's income to match expenditure in year two before generating an annual profit from year three onwards. However, it was not clear how the projected shortfall in income in year one would be met:
- a the business case submitted to WEFO indicated that Antur Penllyn intended to use the projected operating profits in later years to pay off the losses from the first year, but this would take until year four to achieve and the business case did not explain how the loss would be funded during the interim period;
 - b in its initial application for a grant from the Community Facilities and Activities Programme, Antur Penllyn said that it expected grant support and donations to cover the shortfall, although no details were provided about which grants would cover the shortfall or how it was going to attract donations; and
 - c Antur Penllyn told us that it was given to understand that the Welsh Government would maintain the project for the first three years from 'other sources, but that this did not materialise'.

⁴ £18,750 was based on 25 per cent of 25,000 visitors spending £3 per person. £72,000 was based on 40 per cent of the 40,000 visitors spending £4.50 per person.

Decisions to provide grant funding were based on a confused set of objectives for the Centre

- 1.8 Antur Penllyn's original intention was to open a sheepdog trialling centre, to capitalise on the success of the World Sheepdog Championships held at Bala in 2002 and the fact that the first international sheepdog trial had been held on the Centre's site in 1873. In 2000, Antur Penllyn, supported by the Wales Tourist Board, commissioned a feasibility study for establishing a sheepdog trialling centre.
- 1.9 In 2003, representatives of the Rhiwlas Estate wrote to Antur Penllyn confirming that they would lease the site to them for the purposes of a sheepdog trials and heritage centre. Subsequently, in December 2003, Antur Penllyn applied for £498,000 funding from the Wales Tourist Board to open a sheepdog trialling centre. The Wales Tourist Board told us that it did not process this application, as it had understood that WEFO was to meet the full costs of the project. However, in September 2004 Antur Penllyn approached the Wales Tourist Board again for funding, stating that WEFO was no longer in a position to cover the project costs in full. The Wales Tourist Board received a number of concerns over the proposal for a sheepdog trialling centre due to the potential impact upon a nearby sheepdog attraction⁵. Nevertheless, in December 2004, the Wales Tourist Board invited Antur Penllyn to make a formal application for funding, which it received in May 2005.
- 1.10 During the period between Antur Penllyn's initial request for funding and its application to the Wales Tourist Board in May 2005, the emphasis of the project had changed from a sheepdog trialling centre to a rural life and sculpture park. This shift in emphasis was clear in Antur Penllyn's initial application for funding from WEFO in December 2004. The application was for funding for a 'rural life and international sculpture centre', although sheepdog trials were also envisaged on an 'occasional' basis. The Wales Tourist Board ascribes this change in focus to the concerns it had raised with Antur Penllyn about the potential impact of a sheepdog trialling centre on Ewe-Phoria.
- 1.11 Antur Penllyn told us there was a logic to the project integrating rural heritage and sculpture, as cultural life in the area is intertwined with the everyday lives of the rural community. However, the rationale for creating a rural life and sculpture centre was not otherwise clear, particularly given the original intention of opening a sheepdog trialling centre.
- 1.12 The initial plans for the rural life and sculpture centre were scaled back to secure the grant funding from WEFO. This resulted in a smaller main building and a reduction in the area covered and protected from rain. This further compromised the potential viability of the Centre, particularly as key attractions, such as the sculptures, amphitheatre and children's play area, had to be accessed in the open air. The plans upon which grants were approved offered little to a visitor in poor weather. The income and expenditure profiles set out in Antur Penllyn's business case for the Centre that was provided to funders were based on the scaled back plans.

⁵ Ewe-phoria is a Sheepdog Centre in Corwen, which is nine miles from Bala. At Ewe-phoria, visitors can meet sheepdog puppies, watch dogs herding sheep, discover a variety of sheep breeds and learn all about shearing.

1.13 The business case for the Centre did not clearly articulate the specific attractions and events that the Centre would provide, nor how these would be refreshed over time to ensure visitors return.

In addition:

- a the business case was based on attracting members of the local community and tourists to the Centre, but it did not set out clearly what the Centre had to offer these very different groups, and how they would be encouraged to visit and re-visit the Centre; and
- b the business case listed a total of 96 activities and events 'being developed' for the first phase of the Centre, but their volume and wide-ranging nature, from flower arranging to antiques fairs, reflected a lack of clarity of purpose and a lack of focus on how tourists were to be persuaded to go out of their way to visit the Centre.

1.14 The main funder, WEFO, committed resources to the project based on a business plan for a rural life and sculpture centre at a time when funding had not been secured for the sculptures. The Arts Council of Wales approved a grant for the costs of the sculptures more than 12 months after WEFO had given its grant approval for the project. As a result, WEFO had committed public money to support something that it could not be sure would be delivered.

The single largest funder, WEFO, did not adequately challenge the income assumptions or the lack of a clearly articulated plan for what the Centre was to offer, although some of the other funders did identify and share some concerns

1.15 The main funder, WEFO, and the former Welsh Development Agency failed to adequately scrutinise and challenge the key assumptions underpinning the grant applications from Antur Penllyn. The financial appraisal that fed into WEFO's consideration of the grant application assessed income levels as 'uncertain' and identified the initial projected operating loss. The Wales Tourist Board had also raised with WEFO, through a series of letters and meetings during 2005, its concerns about the forecast visitor numbers, the scale of the proposed fees, wage costs and the forecast spend in the café. For example, in an October 2005 letter to WEFO, the Wales Tourist Board wrote of its 'concerns regarding the viability and sustainability of the project, particularly related to the presented visitor numbers and financial projections'.

1.16 We found no evidence that WEFO took any action in response to these concerns. WEFO did not, for example, then subject the key assumptions within the business case to further scrutiny. Nor did it carry out any sensitivity analysis on the figures provided to determine the sensitivity of the project's viability to variations in key assumptions. The Welsh Development Agency also failed to challenge any of the key assumptions underpinning the business case, or to identify the income shortfall.

- 1.17 A number of the other funders scrutinised and challenged the figures Antur Penllyn provided and, as a result, recognised there was a risk to the viability of the project:
- a the Wales Tourist Board pressed Antur Penllyn to provide evidence for visitor numbers; in particular, it requested that Antur Penllyn provide a strong argument to substantiate the rise to 40,000 visitors per annum by year five, although we found no evidence that Antur Penllyn had provided this further information;
 - b the Wales Tourist Board also challenged the assumptions about entrance fees and café income, and the rationale for the evolution of the project from a sheepdog trial centre to a rural life and sculpture centre;
 - c the initial assessment by the Community Facilities and Activities Programme concluded that the figures provided by Antur Penllyn were 'not based in fact', and raised concerns over whether the project was well conceived; and
 - d an external appraisal commissioned by the Arts Council of Wales concluded that the overall viability of the project was questionable, and noted that new ventures experience a fall-off in visitor numbers after the first year before reaching a plateau, rather than the year-on-year increases projected by Antur Penllyn.

Part 2

Funders did not identify and address all of the key risks and placed too much emphasis on the potential benefits of the project, and collaboration between funders was inadequate to support effective decision making



Most funders adequately identified the capacity of Antur Penllyn to deliver the project as a risk, but not all identified as key risks the lack of a robust business plan and a fit for purpose marketing plan

- 2.1 Antur Penllyn was a community regeneration company established in 1989 run by a volunteer board of directors. The company had previously been involved in a number of initiatives, such as setting up a local shops group and a local tourism group. However, none of the projects had matched the size or complexity of the Centre. The proposed project required the redevelopment of some buildings, the employment and management of 11 staff, and the ongoing operation of what needed to be a large and successful visitor attraction for it to be viable. The Antur Penllyn directors told us that they had some concerns about their capacity to manage the project, as it had evolved from a 'major project to a massive project', although they had been 'fairly confident' that they could run the project, given their varied experience.
- 2.2 The limited project management and financial expertise of Antur Penllyn should have been clearly evident to funders during the grant application stage. For example, the business case submitted to the Community Facilities and Activities Programme did not match income to expenditure over each of the initial years of the project. Although subsequent versions of the business case contained more financial detail, it was still not sufficiently comprehensive given the size of the proposal and the grants being applied for.

- 2.3 With the exception of the Welsh Development Agency, funders identified either explicitly or implicitly that the capacity of Antur Penllyn was a key risk to the project. For example, WEFO gave Antur Penllyn the highest risk score for its 'experience in managing projects' and the Wales Tourist Board's appraisal report stated 'the applicant does not have a strong tourism background and officers question the expertise to make the project sustainable'. However, only the Arts Council of Wales and the initial assessment by the Community Facilities and Activities Programme identified the lack of a robust business plan and a marketing plan as key risks.

Some funders did not adequately recognise the risk to the asset should the Centre fail

- 2.4 We would have expected funders to consider how best to protect their investment in the buildings and the artwork should the Centre fail. Only two funders, the Wales Tourist Board and the Arts Council of Wales, identified this risk to their investment as part of their appraisals.
- 2.5 WEFO did not adequately recognise the risk to the asset should the Centre fail. WEFO approved the project prior to the lease agreement between Antur Penllyn and the landowner being signed. WEFO told us that to enable it to fully assess and manage the risk this posed it withheld payments to the project until after Antur Penllyn had signed the lease agreement with the landowner – a process known as 'payment suppression'. However, in March 2007 WEFO lifted the payment suppression without fully examining the provisions within the lease, and only sought legal advice on the lease a year later.

Grant conditions, the main mechanism for managing the risks identified, were not always comprehensive or realistic

- 2.6 The setting of grant conditions was the main mechanism funders adopted for managing the risks that they had identified. For example, to mitigate the risks created by the terms of the lease agreement:
- a the Wales Tourist Board set a condition which meant that Antur Penllyn could not legally dispose of the asset without the consent of the National Assembly for Wales; and
 - b the Arts Council of Wales set a condition that required confirmation of the ownership of artworks should the Centre close, and the development of a strategy to ensure that artworks remained accessible to the general public (either through continued access on site or by re-siting them elsewhere).

2.7 However, we found that grant conditions did not cover all of the risks that funders had identified. For example:

- a WEFO and the Wales Tourist Board did not include any conditions to address Antur Penllyn's lack of project management experience that they had identified;
- b the Arts Council of Wales did not include a grant condition that Antur Penllyn develops a comprehensive, fully-costed budget, despite this being identified as a risk by its external assessors;

- c although WEFO had determined that income from the project was 'uncertain', and set a grant condition that Antur Penllyn must secure a bank overdraft or loan of £60,000 to cover the projected temporary shortfall in operating income, it did not seek any further assurances about projected income levels;
- d the second assessment by the Community Facilities and Activities programme identified a shortfall between income and expenditure, but no action was taken to address the risk that this posed to the sustainability of the project; and
- e none of the funders had required, as a condition of grant, Antur Penllyn to report performance (in respect of visitor numbers, income and expenditure) to enable them to monitor against business case assumptions.

2.8 The absence of conditions to address the lack of experience and capacity within Antur Penllyn was a serious failing. For example, funding could have been made dependent upon the recruitment of staff with experience of tourism and successfully delivering large-scale projects. Also, by not requiring Antur Penllyn to provide periodic reports on the operational performance of the Centre, funders were unable to monitor risks to the financial viability of the Centre and the likelihood that they would need to take action should the Centre appear to be heading for failure.

2.9 The Wales Tourist Board made its grant offer 'conditional upon WEFO addressing the project's financial forecasts in terms of viability, with particular note given to the high wage forecast and projected losses'. However, this condition was unrealistic, because the main funders had never established that they would develop and implement a collective approach to identifying and managing project risks.

Some funders placed too much reliance on the scrutiny arrangements of WEFO, which was an enthusiastic supporter of the project

- 2.10 Under the agreed arrangements for managing the Welsh Government's Pathways to Prosperity fund, fund managers did not carry out detailed appraisals of projects. Projects applied to the fund, and were granted approval 'in principle', where they could demonstrate that all other avenues of funding had been exhausted and where projects could show that their outcomes were aligned with the strategic targets of the Welsh Government's Department for Environment and Transport. Projects with approval in principle were then subject to WEFO's routine appraisal processes, and only once WEFO had approved a project was Pathways to Prosperity funding confirmed.
- 2.11 It is clear that WEFO was very enthusiastic about the project and actively encouraged the Welsh Government's Community Facilities and Activities Programme to also consider funding the Centre. The Community Facilities and Activities Programme rejected the initial application to provide grant support for the project. Subsequently, WEFO confirmed its support for the project on a number of occasions, and asked that the second application for Community Facilities and Activities Programme grant be considered 'as a vital source of funding for this project'.
- 2.12 Some funders placed too much reliance on the scrutiny by WEFO, the largest single funder. We have not been able to establish whether the Welsh Development Agency carried out its own full financial appraisal, but its reviewing officer had advised that a separate appraisal was not needed as WEFO had already scrutinised the project's business case. The second application to the Community Facilities and Activities Programme, which succeeded, was based on substantially the same business case as provided previously and which had been the subject of heavy criticism. The appraisal of the second application was conducted by a different appraisal officer who did not look at the assessment of the original application. The change in the appraisal outcome reflected, at least in part, assurances taken from WEFO's support for the project. In particular:
- a WEFO was likely to commit substantial funding in comparison to the amount being considered by the Community Facilities and Activities Programme; and
 - b WEFO, through its scrutiny of the project, had found 'no issues with the project'.

In making its funding decision WEFO placed too much emphasis to the potential benefits of the project, and there is evidence of other pressures informing decisions to approve funding

- 2.13 Funders had identified a number of benefits that the project could deliver. For example, the Ministerial submission seeking approval for Pathways to Prosperity funding stated that the Rural Thematic Advisory Group⁶ had 'reviewed the strategic merits of the project and felt it to be one of the best it has considered and is very keen to support it'. Bala was designated a Wales Tourist Board special interest tourism growth area, and the project was seen by funders as supporting a number of strategies such as the Welsh Government's Cultural Tourism Strategy, the Wales Tourist Board strategy on sustainability, partnership, quality, equality and creativity, and Gwynedd Council's Economic Development Strategy.
- 2.14 WEFO placed too much emphasis on the potential benefits of the Centre without identifying and putting in place adequate arrangements to mitigate or manage the associated risks. WEFO told us that it had decided to approve the project despite the risks it had identified because it was the only project in the geographical area, and that it addressed 'One Wales' commitments to create jobs across Wales and develop thriving rural communities. In recommending the approval of Pathways to Prosperity funding to the Minister for Economy and Transport, the head of the Pathways to Prosperity fund described the project as 'deemed by WEFO as a high priority and vital

to assist in meeting their targets'. This appears to overstate the importance of a project that aimed to create a relatively small number of jobs (seven full-time staff and four seasonal casual workers). Moreover, in other documents related to the project WEFO had assessed the project as having a limited impact on its overall programme delivery, because of the small contribution that the project was making to the overall programme target for jobs.

- 2.15 The need to spend European Structural Funds, rather than return the money to Europe, also informed the decision to fund the project using the Pathways to Prosperity fund. In August 2005, the head of the Pathways to Prosperity fund sought approval from the Minister for Economy and Transport to fund the Centre stating 'This is a worthwhile project which is also vital to avoiding N+2 decommitment.'⁷ The Wales Tourist Board, despite its concerns over the viability of the project, approved the grant, with conditions, to ensure there was adequate match funding to allow WEFO to approve the project.

Improved collaboration between funders would have supported better decision making

- 2.16 There was regular communication between different funders on the progress being made with the grant applications from Antur Penllyn, and some funders shared key concerns with WEFO. For example:
- a the Wales Tourist Board and WEFO discussed the former's concerns about Antur Penllyn's income forecasts and the project's wage bill;

⁶ Thematic advisory groups have a small number of members selected for their expertise, who advise WEFO on the strategic direction and most effective use of resources in the area of the programme which they cover, including the selection of projects during the development and appraisal process. For example, they may comment on how well a proposal meets strategic priorities, and whether the costs, timing and outputs are realistic.

⁷ Introduced for the 2000-2006 round of Structural Funds programmes, the N+2 rule operates in the following way. Member states and the European Union agree an allocation for each year of each programme. Member states must then spend each year's allocation within two years. For example, the allocation for 2002 needed to be spent by the end of 2004. Money that is not spent within two years is 'lost' to the member state as it must be returned to the European Union in a process known as 'decommitment'.

- b the Arts Council of Wales shared with WEFO its concerns about the viability of the project, and asked about the security WEFO had over the asset to help ensure adequate measures were in place to safeguard the Council's investment; and
- c the Community Facilities and Activities Programme and WEFO discussed WEFO's overall views of the project and whether WEFO had identified any substantive concerns or risks.

2.17 Although there is evidence of bilateral communications, the funders did not come together and develop a collective and coordinated approach to the sharing of grant appraisals and the identification and management of key risks. It is difficult to determine whether or not the project would have progressed as it did if all funders had shared in full their concerns and the risks they had identified. However, as a minimum, better communications and a more collaborative approach to grant appraisal and risk identification and management would have given funders a firmer foundation on which to base their decisions.

Part 3

Although most of the grant conditions that were set were followed up, monitoring of the Centre's operations was inadequate and WEFO invested further public money without gaining any assurance about the Centre's financial viability



Most grant conditions were followed up, but monitoring of the Centre's operations was inadequate

- 3.1 Two of the three funders who set substantive grant conditions robustly followed these up. WEFO achieved compliance with all nine of its special conditions. The Arts Council of Wales also rigorously followed up on its eight special conditions of grant. For example, it:
- a suspended payments until an adequate level of assurance was received on one grant condition – confirmation from the landowner that the artwork would continue to be accessible should the Centre close; and
 - b withheld the final payment of £18,480 as another grant condition was not met – a fit-for-purpose marketing and awareness-raising strategy.
- 3.2 However, the approach by the Wales Tourist Board was more variable with some, but not all, grant conditions being followed up. For example:
- a it successfully ensured that Antur Penllyn signed the legal documents needed to ensure that the company could not dispose of the asset without the written consent of the National Assembly for Wales; but
 - b we could find no evidence that two conditions were followed up and met – details of how Antur Penllyn was going to improve the Centre's exhibitions, and on the Centre achieving a minimum of a four-star Green Dragon Environmental Standard.
- 3.3 WEFO closely monitored the building of the Centre. Antur Penllyn provided weekly updates on progress, which WEFO scrutinised and challenged, and WEFO held quarterly meetings with Antur Penllyn, in line with a grant condition. However, these meetings, which were not always minuted, focused upon the construction of the buildings; WEFO did not monitor progress on the operational aspects of the Centre or on any steps being taken to manage the risks to the Centre's financial viability:
- a we found no evidence of WEFO requesting or receiving from Antur Penllyn any information about visitor numbers, income generated through entrance fees and/or income generated by the café or office space. Until we carried out this investigation, WEFO was unaware that Antur Penllyn had not charged anyone to visit the Centre; and
 - b from the point at which the Centre was intended to be fully operational, in December 2008, WEFO had very little contact with Antur Penllyn until January 2010 when the proposed closure of the project was discussed.
- 3.4 Other funders also did little to monitor the Centre's operational performance. This was either because funders, such as Pathways to Prosperity, were reliant on WEFO to carry out monitoring, or because the amount granted did not exceed internal thresholds for detailed monitoring, as was the case with the Arts Council of Wales.

WEFO granted substantial additional funds for the project, without seeking any additional assurance about its viability or taking the opportunity to put in place more effective action to mitigate the project's risks

3.5 In April 2008, WEFO approved an additional grant of £350,000, to meet a VAT shortfall which had resulted from Antur Penllyn not being able to register for exemption from VAT. The Arts Council of Wales was also approached by Antur Penllyn for an additional grant to cover the VAT shortfall relating to the artworks. However, rather than increase the amount of grant, the Arts Council of Wales agreed for some of the artworks to be scaled back to enable the VAT shortfall to be met.

3.6 At the time that WEFO was considering the application for a grant to cover the VAT shortfall, the Welsh Government's Department for Economy and Transport shared with them a consultant's critical report which identified problems with the infrastructure on the site and with operational aspects of the project (Figure 1).⁸ The consultant concluded that without significant changes the 'project will fail quite miserably'.

3.7 The consultant's report concluded that further substantive funding, in addition to the increased funding required to meet the VAT shortfall, was needed to give the Centre a chance of success. In response, WEFO required Antur Penllyn to provide it with a business case for the additional grant. A business case, drawn up with the support of the consultant, was submitted by Antur Penllyn in August 2008. It identified 'serious deficiencies' with the Centre including:

- a the Centre offering poor value for money to the visitor, with a visit time of only 10 to 30 minutes, depending upon whether they used the café, and offering no reason to return;
- b a lack of rain cover, for example the amphitheatre did not have a roof;
- c limited capacity in the kitchen and café; and
- d inadequate space and rooms at the Centre and toilets on the site.

Figure 1 - Independent report on the Centre and proposed capital enhancements

The consultant identified the need for capital enhancements, with the particular aim of making the Centre more resilient to poor weather. The consultant also identified the following problems:

- a revenue shortfall with no funding available for the costs of the Centre manager beyond June 2008 and the two assistants beyond September 2008;
- the project lacked a strategic direction – there was no clear idea of what the facility should be;
- the corporate/organisational structure for the project was not clear; and
- the Centre did not have a strong marketing plan or business plan – Antur Penllyn did not know what volumes it needed to cover the costs of the Centre and, beyond the overdraft facility, there was 'nothing in place' to keep the Centre running.

Source: Wales Audit Office review of WEFO case files

⁸ We were unable to identify the reasons why the Department for Economy and Transport commissioned a review of the project by a business consultant.

- 3.8 The business case proposed a number of steps to address these deficiencies. These included widening the focus of the Centre with an expanded programme of events; additional capital works and revenue support; and, as a last resort, reducing the Centre's running costs. WEFO subsequently agreed additional funding of £863,546, which was approved in two tranches:
- a in September 2008, WEFO made £799,660 available to address the revenue shortfall and enhance the facilities; and
 - b in March 2009, WEFO made £63,886 available to cover additional construction costs and to purchase a marquee to enable the Centre to provide wet weather activities.
- 3.9 In a paper updating the Deputy First Minister on its decision to grant additional funding to the project, WEFO acknowledged that 'there is an element of risk in pouring more funds into this venture. ...However with these enhancements there is a real opportunity to make good some of the current deficiencies and provide a stronger basis for the Centre to succeed.'
- 3.10 The WEFO decision to provide the additional funding for the Centre was taken in an 18 month period during which it agreed extensions or increases in funding for 240 different projects. During this period WEFO redistributed more than £50 million of additional funding that had arisen from exchange rate movements and late decommitments. Managing this number of projects was clearly a challenge for WEFO, which was a factor that led to the significant shift in approach in the following 2007-2013 funding round, where resources are focussed on fewer projects.
- 3.11 The business case to support the application for additional funds for the Centre contained a number of fundamental weaknesses which were not identified or followed up by WEFO. For example, the business case:
- a included some limited income and expenditure figures, but it acknowledged that 'these estimates are somewhat illustrative...but will be reviewed and will change for the new business plan'. However, no new business plan was ever produced;
 - b did not include any detailed analysis of operating income and expenditure to establish whether, and when, the Centre would become viable;
 - c was based on the Centre attracting 26,000 entrance fee paying visitors and outlined an expanded programme of events to meet this target, but it was unrealistic to expect that visitors for many of the events, such as monthly clubs and courses, would pay an entrance fee; and
 - d envisaged a significant change in purpose for the Centre, with far greater reliance placed upon attracting the local community rather than tourist trade, but WEFO did not scrutinise the change and its impact to establish whether it would be likely to provide a more viable business.

- 3.12 WEFO told Antur Penllyn that due to the consultant's negative findings they would require more frequent progress meetings, and that it would ensure that any revised grant offer letters incorporated a special condition that clearly states that there are to be 'monthly review meetings of progress (on pre-set dates) which allow us (WEFO) to close the project if its delivery is beyond a yet to be agreed tolerance'. However, the subsequent grant offer letters in September 2008 and in March 2009 placed no such requirements upon Antur Penllyn. Rather, both offer letters continue to require quarterly monitoring meetings as set out in the original grant offer letter.
- 3.13 WEFO did not subsequently scrutinise or seek assurance from Antur Penllyn on the delivery of the events or attendance numbers as set out in the business plan for 2008-09. Nor did WEFO ask Antur Penllyn to provide it with a similar business plan for 2009-10.

Part 4

Funders were slow to respond to the threat of, and actual, closure of the Centre and to protect the public's interests in the assets



The Centre was kept open by volunteer staff operating reduced hours until the asset retention period had passed

4.1 The Deputy First Minister opened the Centre in April 2008. We have been unable to find much meaningful information about the operational performance of the Centre between April 2008 and when it closed in September 2011. This is because none of the funders required Antur Penllyn to report progress against the key determinants of performance (such as visitor numbers and spend per head at the café), and Antur Penllyn itself did not keep records of visitor numbers. The accounts of Antur Penllyn show that the Centre made a loss in two of the last three operating years, and that there was an underlying issue with the profitability of the Centre. If the grant funding to cover revenue costs is excluded, the Centre made a loss in each of the last three years, totalling £83,314.

4.2 Antur Penllyn's directors told us that some of the organisations which had used the building for meetings had spoken highly of the facilities. They also told us that in 2011 the Centre had held a number of successful events, such as a Winter fair, an Easter fair, the Robin Jac Festival, a circus school, a country fair and a number of concerts and exhibitions. Antur Penllyn also provided us with a copy of the visitors' book which included a range of positive comments. However, the limited information that the directors were able to provide on the operational and financial performance of the Centre indicates that it had failed to deliver against a number of the key assumptions set out in the business case approved by WEFO:

- a the total planned operational income and expenditure figures bear little resemblance to those reported in Antur Penllyn's accounts, with both expenditure and, in particular, income being far lower than planned;
- b the Centre never generated any income from visitor fees. The Antur Penllyn directors decided not to charge an entrance fee because, even subsequent to it opening, the Centre resembled a 'building site', as further work was ongoing to make the Centre more resilient to poor weather;
- c the business case approved by WEFO had included the assumption that the entrance fee would include a charge to see a range of artworks located around the site. However, the artworks were not unveiled until April 2009, which meant that for a year the sole attraction at the site was an exhibition on rural life;
- d the directors told us that the café was making an operating profit of £10,000 per year. However, we were unable to compare the profit figure of £10,000 to the business case assumptions, as the business case referred only to yearly income from the café, rather than yearly profit; and
- e as envisaged in the business case, the Centre had rented out its meeting room to generate income. However, Antur Penllyn's accounts show that the planned level of income (£6,700 in the first year rising to £13,650 in year four) from hiring out the meeting room was not met, with the room generating income of £3,561 in the first year and £6,111 in year three.

- 4.3 In January 2010, Antur Penllyn informed WEFO that the Centre was about to close. In March 2010, WEFO confirmed to Antur Penllyn that should the Centre close before 9 July 2011 it would seek to reclaim a proportion of the grant, as closure would be within the five-year asset retention period⁹ stipulated as a condition of grant. In March 2010, the Centre manager left as there was no longer any funding for the position. Subsequently, the Centre remained open until September 2011 with reduced hours and staffed by volunteers. The directors of Antur Penllyn told us that during this period they put £20,000 of their own money into the project to clear the Centre's outstanding debts.
- 4.4 WEFO had e-mail and telephone contact with Antur Penllyn over the operation of the Centre and the staffing arrangements until June 2010. However, we found no evidence of any substantive action by WEFO after June 2010, until reports in the media in January 2013 brought to WEFO's attention that the building had apparently been handed over to the landowner.
- 4.5 The WEFO Article 30 team¹⁰ confirmed that the Centre remained open until after the end of the asset retention period. In September 2012, the Article 30 team reported that 'The Centre at present is closed ... but it had continued to function for the required length of time [to be] compliant with EU regulations.'

Funders did not act in a timely and coordinated way to protect the public's interests in the asset

- 4.6 Although WEFO had been informed of the difficulties that the Centre was facing, leading up to its closure in September 2011, it did not share this knowledge with the other funders of the project. It was not until January 2013, when reports of the Centre's closure appeared in the media, that WEFO had any communication with other funders. Following this media coverage the Welsh Government acted to identify the extent to which it had any interest in the buildings, and whether there was any scope to reclaim grant monies. This included a review by the Welsh Government's Sustainable Futures directorate (Figure 2), and WEFO and Visit Wales working closely with the Welsh Government's Legal Services.
- 4.7 The Centre had no cash assets from which funders could have recovered grant paid. And, as at December 2013, the Welsh Government has yet to clarify the exact position regarding ownership of the building. However, it is possible that, at no costs to themselves, the owners of the Rhiwlas estate will ultimately take possession of a building constructed using £3.4 million of public funding.

⁹ The standard WEFO grant offer letter contains a condition which stipulates that a project needs to operate for five years from the date of the initial grant approval. Where projects do not operate for the required five years, WEFO can seek to reclaim a proportion of the grant awarded; a process known as 'claw back'.

¹⁰ The Article 30 team is responsible for checking that equipment and/or buildings which have received European Structural Funds continue to be used for the purposes for which the grant was approved for at least five years following approval. The team is named after the relevant European Council regulation, namely Article 30 (4).

Figure 2 - The Welsh Government's 2013 review of public funding of the Centre

Following the media reports of January 2013 about the closure of the Centre, the Welsh Government undertook a review of the actions taken by the Centre's public funders. The review concluded that the 'due diligence process did identify key project risks. However, there is little evidence that these risks were effectively managed or mitigated.' The review found that:

- Antur Penllyn lacked experience in terms of delivering projects on the scale of the Centre.
- Due diligence throughout the course of the project focused predominantly on the construction of the asset rather than the long-term sustainability of the project. For example, the review found 'little evidence' that funders had given 'due consideration' to whether the Centre had a viable programme of events necessary to generate the income needed to sustain it.
- During the appraisal stage, WEFO had identified that Antur Penllyn was liable to pay VAT, although Antur Penllyn had informed WEFO that, were its application to be successful, it would register for VAT exemption. The review found that public funders did not do enough to clarify Antur Penllyn's VAT status, despite identifying that the project would potentially require an additional £351,373, should Antur Penllyn fail in its application to HMRC to become exempt from VAT.
- WEFO approved the project prior to the lease being signed, and to manage the associated risks WEFO stipulated that it would not make any payments to the project until the lease had been signed. However, it did not seek legal advice on the lease before beginning payments and did not identify fundamental issues with the lease. Legal advice received by the Arts Council of Wales found that 'the lease is somewhat biased towards the landlord' and there are 'tenant unfriendly provisions, such as the length of the lease'. The lease is for a 50-year period, which the legal advice considered to be too short to be marketable.
- The agreement between WEFO and Antur Penllyn included the provision of in-kind match funding worth £200,000, in the form of the value of land leased to the Centre. The 50-year lease was independently valued at £240,000. However, over the first 15 years of the lease Antur Penllyn was required to pay the Rhiwlas estate rental payments worth more than £63,300, with increases in the annual rental after the first 15 years.¹¹ Therefore, the review questioned whether £200,000 of in-kind match funding had actually gone into the project.
- The review cites legal advice received by the Welsh Government, which was that, if the building has returned to the landlord, 'there is potentially an issue of state aid to the landlord'.

The review also considered the scope for public funders to reclaim any grant monies paid to Antur Penllyn. In so doing, it identified a number of grant provisions which the Welsh Government might choose to use to trigger claw back. However, it also stated that the likelihood of the Welsh Government recovering any funds was low, as Antur Penllyn had no fixed assets and very limited liquid assets.

Source: *Welsh Government Briefing on the Canolfan Cywain project, February 2013*

¹¹ The lease conditions require Antur Penllyn to make rental payments in the first 15 years of the lease of £63,300. However, due to the nature of the formula used to calculate annual rental payments for the remainder of the lease, the Welsh Government's review was not able to identify the total value of the rental payments.

- 4.8 On 30 September 2013, Antur Penllyn and the landowner signed a 'deed of surrender' to reassign the lease for the land to the landowner, which would also have resulted in the transfer of the building to the landowner. However, the Land Registry has not registered the transfer of title, due to the restriction that had been placed upon the property by the Wales Tourist Board. This restriction requires Antur Penllyn to secure the consent of the National Assembly for Wales to any disposal of the asset. Antur Penllyn has neither sought nor secured such consent, and consequently the Land Registry has not registered the transfer of the title.
- 4.9 The position is further complicated as Antur Penllyn was dissolved by voluntary strike off¹² in June 2013. It was not until December 2013, and only then in response to queries raised as part of this investigation, that the Welsh Government sought legal advice on the consequences of the dissolution of Antur Penllyn. The legal advice concluded that the dissolution of Antur Penllyn meant that the Welsh Government could not initiate legal proceedings against Antur Penllyn to recover any funds owed to it, should it be found that Antur Penllyn had breached the terms of its grant.
- 4.10 Also, as at December 2013, WEFO had not followed through to a conclusion two of the concerns it identified in discussion with the Welsh Government's Legal Services. These were:
- a whether the landowner had provided the agreed match funding worth £200,000 – this is in doubt as the lease had ended before the full term set out in the lease agreement; and
 - b a potential issue of state aid¹³ as the landlord may have benefited from a publicly funded building for no consideration.
- 4.11 The Arts Council of Wales has also been slow in acting to ensure continued public access to the artworks. In 2008, the Arts Council of Wales secured a clear commitment from the landowner that, should the Centre close, public access to the artworks that cannot be removed from the site¹⁴ could continue for a period of 15 years¹⁵ and the landlord would cooperate in the removal of artwork that could be relocated.
- 4.12 Also in 2008, the Arts Council of Wales had agreed a decommissioning plan with Antur Penllyn for the artworks that could be moved. The plan set out that Antur Penllyn was responsible for funding the costs of removing and re-sighting the artworks and for insuring and maintaining them. As part of the decommissioning plan, Gwynedd Council agreed to help Antur Penllyn find external funding to meet the costs of re-sighting the works should this become necessary; and Snowdonia National Park committed to allowing the artworks to be displayed on land that it owns nearby.
- 4.13 However, it was not until September 2013, during the course of this investigation, that the Arts Council of Wales wrote to the landowner to seek confirmation that the artworks remain accessible to the public. As at December 2013, we are not aware of any reply from the landowner. The Arts Council of Wales told us that it would contact other interested parties, such as Gwynedd Council and the Snowdonia National Park, when it had received a reply from the landowner about the accessibility of the artwork.

¹² Voluntary strike off is the process by which company directors close a company by applying to Companies House for the company to be struck off the register of companies.

¹³ The European Commission defines state aid as 'advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities'. As state aid is seen as giving a company advantage over its competitors, there is European Union legislation to govern its use.

¹⁴ The nature of two of the artworks, an amphitheatre and etchings on the glass doors to the café means that they cannot be removed from the site.

¹⁵ The Arts Council of Wales' monitoring period for the grant (standard 15 years) ends in 2023.

- 4.14 The Centre's building, land and artworks have not been maintained since its closure in September 2011. Antur Penllyn told us that it had decided to leave a number of items, which have been valued by a land agent at £40,000, on the site to 'facilitate things in the hope that someone else would take over'.
- 4.15 There has been no communication or coordination between the funders and with other stakeholders, such as Gwynedd Council and the Snowdonia National Park, around what options exist for the Centre and whether it might be brought back into use for the benefit of the public and local community. Whilst the asset retention period had passed for many funders, it is our view that in these circumstances funders have a continued responsibility to maximise the chance that the considerable amount of public money that went into the Centre results in some ongoing public benefit.

Appendices

Appendix 1 - Funding streams for the Centre

Appendix 2 - Investigation methods

Appendix 3 - Timeline of key events



Appendix 1

Funding streams for the Centre

Funding organisation	Grant programme	Amount initially approved (£)	Amount finally paid (£)	Difference (£)
WEFO	European Agricultural Guidance and Guarantee Fund	900,000	2,094,917	1, 214,919
Welsh Government	Pathways to Prosperity – S126 Housing Grants Construction and Regeneration Act 1996	644,950	644,950	0
Welsh Government	Community Facilities and Activities Programme	270,000	270,000	0
Welsh Development Agency	Community Regeneration Toolkit – Revenue	52,310	52,310	0
Welsh Development Agency	Section 15 Environmental Grant	100,000	100,000	0
Wales Tourist Board	Section 4capital Grant	87,500	87,500	0
Antur Penllyn	Internal resources	52,480	52,480	0
Snowdonia National Park	Sustainable Development Fund	34,999	34,999	0
Arts Council of Wales	Lottery	200,000	181,520	(18,480)
Rhiwlas Estate	Match-funding land value	200,000	200,000	0
Total project funding		2,542,239	3,738,678	1,196,439
Total public sector funding		2,289,759	3,486,198	1,196,439

Welsh European Office Funding

WEFO was the largest single funder through Structural Funds. The European Union's Structural Funds support activities that are designed to reduce structural inequalities between different regions and social groups. They are delivered through seven-year programmes agreed between the member state and the European Commission. The payments made to Antur Penllyn were from one of the four funds, the European Agricultural Guidance and Guarantee Fund (EAGGF), as part of the 2000-2006 programming period. The EAGGF was intended to assist the development and diversification of communities in rural areas and was administered by WEFO, part of the Welsh Government, which is directly accountable to the European Union for the management and financial control of the funds.

Projects cannot be totally funded with Structural Fund money. Europe will normally contribute between 45 per cent and 75 per cent towards the total cost of a project. The rest must be raised by the project sponsor and is known as 'match funding'. Match funding can be from applicants' own resources or from public, private or voluntary sector funding; and can either be 'actual', which is a cash contribution, or 'in-kind', where an organisation or individual provides a service or product for which they do not charge. The main sources of matched funding are summarised below.

Pathways to Prosperity funding

Under the 2000-2006 Structural Funds, the Welsh Government established two budgets specifically as sources of match funding for external bodies – one of these was the Pathways to Prosperity fund. The Pathways to Prosperity fund was a match funding 'pot of last resort'. Applicants had to be able to clearly demonstrate that they had tried – and failed – to secure match funding from every other possible source.

Community Facilities and Activities Programme

The Welsh Government's Community Facilities and Activities Programme began in 2002. It is a capital grant programme which aims to provide funding of last resort for organisations seeking to provide or improve community facilities and services.

Welsh Development Agency¹⁶ funding

The Welsh Development Agency funded the Centre through two grant programmes. The Community Regeneration Toolkit, which provided revenue funding, with the aim of providing support for community groups to develop local partnerships and promote the economic development of their community. The second source was a Section 15 Environmental Grant which provided capital funding. Section 15 environmental grants were to fund projects to upgrade, or provide community facilities on reclaimed or derelict land. In order to be selected for the grant, schemes had to be able to demonstrate a likely contribution to the renewal and development of the Welsh economy, as well as the local community.

¹⁶ The functions of the Welsh Development Agency were transferred to the Welsh Government, with effect 1 April 2006.

Wales Tourist Board¹⁷ funding

The Wales Tourist Board provided funding under Section 4 of the Development of Tourism Act 1969. Section 4 of the act makes provision for tourist boards to grant fund 'any project which in the opinion of the Board will provide or improve tourist amenities and facilities', with 'the maximum economic benefit'. The funding given by the Wales Tourist Board to Antur Penllyn was to support the capital expenditure relating to building costs, plant, equipment, furnishings and professional charges.

Arts Council of Wales funding

The funding provided by the Arts Council of Wales was not part of the original package of Structural Funds and match funding agreed by WEFO in July 2006. The Arts Council of Wales' funding of the amphitheater and artworks came from the Lottery Funds it administered.

Private matched funding sources

The funding package agreed between WEFO and Antur Penllyn included £200,000 of in-kind match funding from the Rhiwlas estate, the owners of the land. The estate leased to Antur Penllyn the land on which the Centre is located for a period of 51 years, with staged rental payments throughout the period. The commercial value of this leasehold was £240,000. However, it is unclear how the lease agreement equates to match funding in kind of £200,000.

Antur Penllyn itself also made a match funding contribution of £52,480.

¹⁷ The functions of the Wales Tourist Board were transferred to the Welsh Government with effect 1 April 2006.

Appendix 2

Investigation methods

In undertaking the investigation we gathered evidence from a variety of sources between September and October 2013.

File and document reviews

We undertook a review of files relating to the approval of grants by WEFO, Pathways to Prosperity, Community Facilities and Activities Programme, the Arts Council of Wales, the former Welsh Development Agency, and the Wales Tourist Board (now Visit Wales). We did not review the files from Snowdonia National Park given the small amount of grant involved.

We reviewed a range of documents including the business case for the Centre, internal Welsh Government reports, and the annual Visit Wales reports on visits to tourist attractions.

Interviews and site visits

We were, in the main, able to interview the key officials involved in assessing and approving the grants for the Centre. Although considerable time had elapsed since the approval of grants we were able to identify and meet with the relevant officials in the Welsh Government, WEFO, the Arts Council of Wales, the former Wales Tourist Board, former Welsh Development Agency, and from the former Community Facilities and Activities Programme. We also interviewed staff from Gwynedd Council who were involved in ongoing monitoring of and support to Antur Penllyn. We were unable to meet with any officials that were involved in the Pathways to Prosperity grant approval.

We also met with the former directors of Antur Penllyn and visited the Centre.

Appendix 3

Timeline of key events

Date	Key event
2004	
March	The Welsh Development Agency approves a grant of £100,000 to the project.
October	Antur Penllyn makes an initial unsuccessful application for Community Facilities and Activities Programme funding.
December	WEFO receives initial application from Antur Penllyn.
December	Wales Tourist Board invited Antur Penllyn to make a formal application for funding.
2005	
January	Antur Penllyn reapplies for Community Facilities and Activities Programme funding.
March	The Community Facilities and Activities Programme approves grant of £270,000 to the project.
May	Antur Penllyn submitted a formal application for funding to the Wales Tourist Board.
August	Ministerial approval sought for Pathways to Prosperity funding for the Centre.
October	The Wales Tourist Board approves grant of £87,500 to the project.
	The Pathways to Prosperity fund approves 'in principle' grant of £644,950 to the project.
December	The Welsh Development Agency approves Community Regeneration Toolkit grant of £52,310 to the project to develop its proposals for the Centre.

Date	Key event
2006	
March	Antur Penllyn submits another application to WEFO.
June	Pathways to Prosperity grant of £644,950 is confirmed.
July	WEFO offers grant of £900,000 to the project to fund capital.
November	WEFO places the project on payment suppression – payments are withheld until lease agreement is signed.
December	WEFO receives copy of lease agreement.
2007	
March	WEFO lifts payment suppression.
May	Arts Council of Wales receives application for grant from Antur Penllyn.
	Snowdonia National Park confirms funding of £34,999.
July	External assessors submit critical assessment of the proposed project to the Arts Council of Wales.
September	The Arts Council of Wales approves grant of £200,000 to the project.
	Antur Penllyn confirms that as it cannot register for VAT there is an income shortfall of over £350,000.
November	WEFO confirms to Antur Penllyn it will support increased costs due to VAT changes.
	Arts Council of Wales follows up with Antur Penllyn on outstanding conditions of grant which include written confirmation that maintenance of artworks rests with Antur Penllyn; and confirmation of ownership/access to artworks if the Centre closes.
December	Arts Council of Wales reluctantly accepts that there should be a reduction in the art works to cover the VAT shortfall of £33,850. But, warns that any further reductions to the brief will result in it withdrawing its funding.

Date	Key event
2008	
January	Arts Council of Wales confirms that it will not make any further payments unless the condition about access to artworks is resolved.
February	Revised application received by WEFO to cover increased project costs due to VAT.
March	WEFO obtains internal legal advice on the security of its investment if the project fails.
April	The Welsh Government's Department for Economy and Transport makes WEFO aware of the negative conclusions of the cost consultant it had commissioned to examine the project.
	In advance of attendance at the opening ceremony, officials provide the Deputy First Minister with a written briefing which identifies the issues raised by the cost consultant.
	Approval by Head of Division at WEFO to increase EAGGF contribution to pay the additional VAT costs.
	Deputy First Minister gives address at opening ceremony.
	Revised WEFO offer of grant (now increased by £351,373 to £1,231,371) to cover VAT shortfall.
June	After a number of attempts, the landowner provides the Arts Council of Wales with a satisfactory statement on access, which then recommences payments to Antur Penllyn.
July	WEFO meets with Antur Penllyn, to discuss the consultant's findings and to agree a way forward.
August	Antur Penllyn provides WEFO with a business case for increased funding.
	WEFO provides the Deputy First Minister with an update on progress and confirms its intention to grant an additional £800,000 to facilitate the long-term sustainability of the project.
	Antur Penllyn submits a revised application for additional capital and revenue funding to WEFO.
September	Revised offer of grant from WEFO (now increased by a further £799,660 to £2,031,031) to cover additional capital costs and to cover a shortfall in revenue.
October	The Community Facilities and Activities Programme completes a very brief Financial Evaluation of the project.

Date	Key event
2009	
March	WEFO receives correspondence from Antur Penllyn on the potential 'closure' of the project.
	WEFO revised offer of grant (now increased by £63,866 to £2,094,917) to cover additional building costs and a marquee.
April	Official unveiling of artworks at the Centre by Minister for Heritage.
2010	
January	Antur Penllyn e-mails WEFO indicating that the Centre is to close.
February	The Arts Council of Wales requests that Antur Penllyn provides it with a more comprehensive marketing and awareness strategy as the current version is not fit for purpose.
March	The Centre's project manager confirms to WEFO that they are leaving at the end of March, and that the directors will be running the Centre with volunteer staff.
	WEFO informs Antur Penllyn that if the Centre closes before 9 July 2011 WEFO will be within its rights to 'claw back' a proportion of the grant awarded.
June	Antur Penllyn Director informs WEFO that the Centre is open 9-12 with volunteers.
October	Visit Wales' 'Grading Team' visit the Centre and conclude that it did not meet the criteria for a 'star attraction'. The Grading Team's report states 'It just had a café, temporary exhibition, the gardens and a small shop when we visited. The quality of the buildings, staff service and food quality etc. was very good to excellent.'
November	The Arts Council of Wales decides that it will not release the rest of its grant, because Antur Penllyn has failed to provide it with an adequate marketing strategy.
2011	
September	Centre closes its doors.

Date	Key event
2012	
March	The Article 30 team visits the Centre. (It is responsible for checking that equipment and/or buildings funded by European Structural Funds continue to be used for the purposes originally approved for at least five years following approval of the grant.)
	Antur Penllyn and the landowner sign 'Deed of Surrender' for the buildings and land.
April	Article 30 report issued confirming that the Centre stayed open until after the asset retention period passed.
2013	
January	The Arts Council of Wales becomes aware through the media that the Centre has closed.
	WEFO asks Welsh Government Legal Services for advice on potential for claw back. It receives this advice a few days subsequently in February.
February	WEFO requests and receives from the Welsh Government Legal Services advice on the lease and match funding.
	WEFO requests and receives from the Welsh Government Legal Services advice on the 'Deed of Covenant' and the Land Registry restriction relating to the Wales Tourist Board grant.
March	Visit Wales requests and receives from the Welsh Government Legal Services advice on whether it has 'security of tenure on the site'.
June	Antur Penllyn dissolved by voluntary strike off.
September	Arts Council of Wales initiates contact with landowner over access to art works, as the first step in their decommissioning.

24 April 2014

Archwilydd Cyffredinol Cymru
Auditor General for Wales

European Union Structural Funds 2007-2013



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

I have prepared and published this report in accordance
with the Government of Wales Act 2006.

The Wales Audit Office study team that assisted me in preparing this report
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The Auditor General is independent of the National Assembly and government. He examines and certifies the accounts of the Welsh Government and its sponsored and related public bodies, including NHS bodies. He also has the power to report to the National Assembly on the economy, efficiency and effectiveness with which those organisations have used, and may improve the use of, their resources in discharging their functions.

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The Auditor General undertakes his work using staff and other resources provided by the Wales Audit Office, which is a statutory board established for that purpose and to monitor and advise the Auditor General.

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Summary

- 1 This report examines the administration of the 2007-2013 European Union (EU) structural funding programmes in Wales (**Exhibit 1**). As the 'Managing Authority', these programmes are managed by the Welsh European Funding Office (WEFO), a division of the Welsh Government, and are overseen by a Programme Monitoring Committee¹. Individual projects are overseen by a 'project sponsor' organisation but can involve several partner organisations.
- 2 WEFO's responsibilities include selecting projects and approving their business plans, paying grant and claiming reimbursement from the Commission, monitoring progress and evaluating impact. WEFO is also responsible for ensuring compliance with the regulations governing the deployment of EU funding, with potentially severe financial penalties for non-compliance.
- 3 Reflecting experience from the 2000-2006 programmes, the Welsh Government embarked on the 2007-2013 programmes with a desire to streamline programme structures, focus the programmes more closely on strategic priorities and manage performance more effectively through fewer but larger projects. The Welsh Government also wanted a stronger emphasis on collaboration between stakeholders and greater use of competitive procurement.

Exhibit 1 – Wales and the European Union Structural Funds

Wales is eligible to receive around €2.22 billion from the 2007-2013 EU structural funding programmes, which aim to reduce social and economic disparities between the regions of the EU. Spending under these programmes will continue until the end of 2015. Wales received €2.14 billion under the 2000-2006 structural funding programmes and has been provisionally allocated around the same amount for the 2014-2020 programmes.

As at the end of 2013, the value of the EU funding under the 2007-2013 programmes is equivalent to around £1.9 billion. With other match funding from UK sources, the total value of the programmes over the whole of the programming period is around £3.2 billion.

Because the value of the structural funds programmes to Wales is set in euros at the outset of the programmes, fluctuating exchange rates are part of the challenge in meeting annual spending targets. If these targets are not met, the unspent balance is withdrawn by the EU and is not normally re-committed to the programmes.

The EU funding comes from two main sources:

- £1.11 billion from the European Regional Development Fund (ERDF) for business support, commercial innovation, economic infrastructure, renewable energy and regeneration; and
- £756 million from the European Social Fund (ESF) to support training and other initiatives to increase economic participation and raise the skills of the workforce.

Each of these funds is delivered through two programmes – Convergence and Regional Competitiveness and Employment (Competitiveness) – making four main programmes in total. The Convergence Programmes account for around 94 per cent of the available EU funding and are designed to improve the economy of 15 local authority areas in West Wales and the Valleys that have a gross domestic product (GDP) of less than 75 per cent of the EU average. The Competitiveness Programmes are available for the rest of Wales (known as East Wales).

Each of the four programmes is supported by an 'operational programme' document, a plan setting out how funds will be used to meet agreed objectives. The operational programmes were agreed with the European Commission during 2007. For the 2007-2013 programmes, the operational programmes are complemented by a series of strategic framework documents developed by the Welsh Government that provide additional guidance on priorities and project design.

¹ The Programme Monitoring Committee comprises representatives from various organisations. The European Commission has observer status, receives regular progress reports and undertakes its own audits to verify compliance with its regulations.

- 4 This report considers whether the 2007-2013 programmes have been administered effectively by WEFO and are on track to deliver their intended benefits, examining progress against targets for the allocation of funding, expenditure and key outputs. This report was prepared by staff of the Wales Audit Office on behalf of the Auditor General for Wales. **Appendix 1** sets out in full our audit methodology. We reviewed the overall administration of the programmes at a relatively high level, supplemented by some case studies and supported by a survey of project sponsors and WEFO project development officers (PDOs). More in-depth reviews, such as our recent consideration of WEFO's funding of projects sponsored by the All Wales Ethnic Minority Association (AWEMA), do indicate some weaknesses in administration at project level. We have also taken into account other evaluations and reviews, including Dr Grahame Guilford's March 2013 report on arrangements for the next programming round.
- 5 We have concluded that the programmes have generally progressed well, supported by improved management arrangements when compared to the previous programming round and despite certain difficulties in the early stages. It is too early to assess the overall impact of the programmes, which may not be fully evident for some time after the programmes have closed, but there are positive signs from ongoing evaluations.
- 6 The European Commission has recently reviewed its guidance on the methodology to be used by Audit Authorities (the bodies in each region that audit expenditure on its behalf) in selecting projects for audit. As a result, it is now normally requiring the use of statistical sampling approaches rather than the random non-statistical sampling approach hitherto used by the Audit

Authority in Wales and some other regions across Europe. This has led to a temporary interruption of ERDF payments on technical grounds while error rates are recalculated. Indications are that error rates remain relatively low overall in Wales and the Welsh Government has taken action to ensure that the interruption has not affected payments to project sponsors. The Welsh Government is optimistic that the situation will be speedily resolved.

- 7 In drawing comparisons with the 2000-2006 programmes, we have taken into account the findings from reports by the National Audit Office Wales in 2002 and 2004. We referenced these findings in our December 2013 report on *Public Funding of Penmon Fish Farm*. Penmon Fish Farm received EU funding under the 2000-2006 programmes. We also reported on issues relating to 2000-2006 programme funding in the *Management of public funding of Cymad Cyf* (May 2010) and funding for the Cywain Centre in Bala (April 2014).

The programmes have progressed relatively well overall despite certain difficulties, but it is too early to assess their overall impact

- 8 **Overall, WEFO has made good progress in committing available funds to projects.** Although some project sponsors appear to have expected that the programmes would have got off to a faster start, WEFO has since achieved most of its annual commitment targets, which were more challenging than those set in the operational programmes. Despite the impact of falling exchange rates² and the withdrawal of funding for certain projects following changes in Welsh Government policy, by the end of 2012 most programme areas were fully committed.

² A sharp decline in the £/€ exchange rate after programme approval released a substantial amount of additional funding that needed to be committed to projects.

While progress was slow in some programme areas initially WEFO has responded appropriately to address shortfalls in commitment by working with the Welsh Government to stimulate project development and by re-allocating funding to other areas.

9 **The programmes have met EU spending targets, despite the rate of expenditure overall being slower than forecast by project sponsors.** WEFO has met all the annual spending targets set for each programme, usually by a comfortable margin. In 2010, the European Commission revised its targets for the programmes to take account of the adverse impact of the wider economic downturn on match funding. WEFO decided that it would still seek to meet the original, more demanding, annual targets and has mostly done so.

10 As at the end of 2013, WEFO had certified £2.17 billion of project expenditure as being eligible for reimbursement by the EU. Programme spending rates have been boosted by: an increase in the average intervention rate³ permitted by the European Commission, which released an additional £187 million of EU funding by 31 December 2013; some retrospective funding of projects which were wholly or partially complete before they were approved by WEFO for EU funding; and the payment of £73 million of EU funding into investment funds that counted against the ERDF targets when the money was paid into the funds, not when it was paid out from the funds through investments.

11 Individual projects do not have formal spending targets, but each project sponsor agrees with WEFO a delivery profile which includes forecast spend. In general, the pattern of project expenditure is consistent with the previous programmes. As at December 2013, around one in three projects in progress were 20 per cent or more behind their expenditure profile. The overall shortfall between actual and forecast spending fell from 31 per cent in June 2010 to 19 per cent in December 2013, but much of that improvement is due to project sponsors updating their profiles rather than catching up with their original profiles. Project spending has been slower than forecast for a variety of reasons including general over-optimism, difficulties with procurement and staff recruitment and the impact of the economic downturn.

12 **The programmes are on track to meet, and in some cases far exceed, most of their key performance targets.** Taking the Convergence and Competitiveness Programmes together, WEFO expects to meet the targets it has set for its key 'dashboard indicators' ([Exhibit 2](#)). The ESF programmes, in particular the Competitiveness Programme, have performed strongly and are forecast to exceed all of their programme level targets, many by a substantial margin ([Appendix 4](#)). At the end of 2013, project sponsors' forecasts indicated that the ERDF Convergence Programme would meet six of its 11 programme level targets and the Competitiveness Programme would meet five of its eight targets ([Appendix 3](#))⁴.

³ The intervention rate for an individual project reflects the proportion of a project's total cost that is met by EU funding rather than match funding.

⁴ Overall, the six ERDF programme level indicators that would not be met relate to the five themes of: gross jobs created; investment induced; new or improved products, processes or services launched; waste reduced, re-used or recycled; and profit benefit. The profit benefit measure is intended to capture increases in profits arising from savings or productivity benefits achieved with EU funding support. WEFO has not prescribed any particular method for calculating profit benefit and beneficiaries are finding it difficult to attribute and calculate profits to specific services received from EU funded projects. Under-reporting is likely, although economic conditions are also a factor.

Exhibit 2 – Key performance indicators for ERDF and ESF programmes¹

	Target ²	Forecast ²	% of target forecast to be achieved	Achieved at 31 Dec 2013
Enterprises assisted (ERDF)	15,900	22,038	139%	12,703
Enterprises created (ERDF)	5,604	11,849	211%	7,574
Gross jobs created (ERDF)	38,540	43,052	112%	23,649
Participants (ESF)	294,100	629,227	214%	487,542
Participants entering employment (ESF)	31,000	88,354	285%	53,781
Participants gaining qualifications (ESF)	89,180	235,396	264%	160,847

Notes:

¹ WEFO focuses on between eight and 14 key performance indicators to monitor the delivery of each of the operational programmes. WEFO focuses particular attention on the six indicators listed above that form the basis of its performance reporting as part of the Welsh Government's wider performance management arrangements. We have combined here the Convergence and Competitiveness programme targets for each Fund.

² Target and forecast refer to the end of the programmes. The programmes are expected to close at the end of 2015.

Source: WEFO

13 There are over a hundred monitoring indicators altogether across the four programmes and their respective priorities. There is mixed performance at a priority level, reflecting the particular impact on certain priority areas of changes in economic conditions, policy and the distribution of funding compared with initial assumptions. Based on project sponsors' forecasts at 31 December 2013, 72 of the 125 ERDF priority-level targets and 50 of the 62 of the ESF priority-level targets would be met by the end of the programmes.

14 The programmes are now considerably bigger in terms of total committed expenditure (12 per cent - 38 per cent at the end of 2013) than envisaged when the targets were set, and performance needs to be viewed in this context. For the ESF programmes, the economic downturn has created more demand for employment support and retraining services for the newly unemployed and increasingly for young people entering the labour market. However, it appears that the ESF programme targets were set too low initially. Delivery on most indicators was lagging behind project sponsors' profiled figures at the end of 2013, in part reflecting slippage against projects' spending profiles.

- 15 **The cross cutting themes of environmental sustainability and equal opportunities are better established than in the previous programmes, but the programmes are likely to fall short of most of the related targets.** For example, the proportion of participants from older age groups and those with a work-limiting illness or disability is likely to fall well below the levels expected. However, because the ESF programmes are likely to exceed their overall participation targets by substantial margins, the overall number of women and black minority ethnic (BME) participants is likely to be higher than originally expected, despite the overall proportion of participants from these groups falling short of the targets set. In January 2011, an evaluation commissioned by WEFO reported variable progress among sponsors in integrating the cross-cutting themes into delivery of their projects, and found that sponsors often lacked the knowledge and resources to provide specialist advice to beneficiaries.
- 16 **While it is too early to assess the overall impact of the programmes, there are some positive signs and ongoing evaluations will paint a clearer picture.** The evidence is most developed for the ESF programmes and findings emerging from the ESF Leavers' Survey and other evaluation work indicate a positive effect on participants, but with the programmes' impact on employment rates varying significantly by participants' gender, age, location, state of health and employment history.
- 17 The 2011 ERDF Business Survey results suggest that the ERDF programmes have created or safeguarded a significant number of jobs, but only a minority of respondents credit ERDF with tangible outcomes for their business. The survey findings indicated that the effect of safeguarding jobs was at least as significant as job creation. The survey was based on a relatively small sample of programme activity, but it is being undertaken again in 2014.
- 18 **Evidence for the 2000-2006 programmes suggests a positive impact on jobs and skills, but the prosperity gap between Wales and the EU average remains significant.** An analysis by WEFO in 2011 attributed to the previous programmes the creation of between 26,000 and 45,500 jobs and between 1,700 and 2,500 small and medium sized enterprises (SMEs), with between 48,700 and 89,300 people entering employment or further learning as a direct result of their participation in ESF programmes. It is difficult to assess the wider economic impact of the programmes as they are intended to lead to long-term improvements in economic capacity that are hard to link to specific interventions. In fact, the region's GDP position relative to UK and EU averages worsened between 2000 and 2010, partly because of the effect of commuting between the Valleys and East Wales. However, other indicators such as primary income, employment rates, economic activity rates and qualification levels had all improved to some extent in the period from 2001 to 2008 and with some closing of the gap with UK averages.

Management arrangements are effective and have improved since the previous programming round, despite some disruption in the early stages of programme implementation

- 19 **There have been mixed views about the overall administration of the programmes, although stakeholders generally support the action that WEFO has taken to simplify programme structures and reduce the number of projects.** We found that project sponsors tended to view WEFO's management system as slow and bureaucratic, but felt that it was working better after a difficult start. There was broad support for WEFO's decision to simplify programme structures and to reduce the number of projects (which has fallen from 2,463 in the previous programmes to less than 300), although sponsors raised some practical concerns about collaboration and partnership working and the delivery record of larger projects.
- 20 **The programmes have been flexible enough to respond effectively to the economic downturn and to some significant changes in policy.** WEFO re allocated resources and changed certain eligibility criteria to respond to the economic downturn. In 2009, WEFO used the opportunity of a weaker pound (which had increased the sterling value of the EU funding) to negotiate an increase in grant rates with the European Commission, thus easing pressures on match funding.
- 21 WEFO also worked quickly and effectively with other parts of the Welsh Government to reflect policy changes arising from the launch of the Economic Renewal Programme in 2010. The smaller number of projects compared with the previous programmes, many of them sponsored by the Welsh Government, made this a much easier task than it would otherwise have been. In addition, WEFO has modified the ESF programmes to avoid duplicating the UK Government's 'Work Programme'.
- 22 **The greater use of procurement as a delivery model proved difficult to implement, but if well managed should have positive effects in the longer term.** WEFO expects that around a third of all programme expenditure will be spent through procurement by project sponsors. In practice, many projects operate mixed delivery models, with some services being procured and others delivered directly or via grant schemes.
- 23 Although generally seen as the right approach, the greater emphasis on competitive procurement has been difficult to implement. However, some of the early challenges have been overcome after WEFO reviewed its guidance on delivery models. WEFO has achieved a high level of compliance with procurement regulations⁵, but the extent to which the increased emphasis on competitive procurement has delivered better value for money and wider access to EU funding is less clear. At the end of 2013, project sponsors had awarded a total of 2,569 contracts worth £1.09 billion through procurement, mostly to the private sector (£644 million), with the voluntary sector securing contracts worth £178 million. There is no data available with which to compare these figures with the previous programming round.

⁵ WEFO has achieved a very low rate of error attributable to procurement issues, in contrast to some other part of the EU where the Commission has levied large fines on managing authorities.

- 24 **WEFO has established a robust system to support project development and selection but sponsors can find the process challenging and time consuming.** WEFO has established effective mechanisms for ensuring that projects align with strategic objectives, as set out in the strategic framework documents, but there is scope to develop a more sophisticated approach for the next round of programmes.
- 25 WEFO adopted a new approach to prioritise, develop and select projects for the 2007-2013 programmes, including the introduction of an expression of interest stage to filter out unsuitable projects. Overall, this system is based on sound criteria and has improved the quality of project proposals, helped by the introduction by WEFO of 'project development officers' to provide a single and continuing point of contact for project sponsors. The selection criteria have also been identified as good practice by the European Commission. However, the length of the process and its administrative requirements have been a source of frustration for some project sponsors and opinions about the overall system of support and guidance for project sponsors do vary.
- 26 WEFO has generally effective financial management systems, including a series of 'management verifications', to ensure compliance and to detect errors before project expenditure is declared to the European Commission. Grant claims are scrutinised by WEFO's payments team and subject to independent external audit. WEFO's Project Inspection and Verification (PIV) team reviews sponsors' systems of financial control and inspects project expenditure. WEFO itself is subject to audit by the Audit Authority (the Welsh Government's European Funds Audit Team – EFAT) and the EU's own auditors. The irregularity rate in expenditure declared to the European Commission has been well below the two per cent level that is the maximum accepted by the European Commission. However, as noted in paragraph 6, the Audit Authority is currently in the process of recalculating error rates to meet the European Commission's revised requirements, although the indications are that these remain low overall.
- 27 **Financial management is sound.** The development of a new IT system has made it much easier for WEFO to manage programme finances, as well as streamlining other aspects of programme administration. The system has come at a significant cost – a development cost of £18.1 million and annual running costs of £1.25 million – although it is cited by the European Commission as a benchmark for other managing authorities and WEFO is confident that it will be able to continue using the system for another eight years with little additional investment required.
- 28 WEFO pays grants on a timely basis after making appropriate checks and has recently strengthened controls over advance payments. WEFO is also in a good position to manage fluctuations in the exchange rate and other financial risks as the programmes draw to a close. WEFO is pursuing a policy of over-committing the EU funding allocation to reflect the pattern of under-spending by sponsors in the previous programming round. WEFO intends to identify projects where provision could be scaled back if required or rolled forward through new projects in the next programming round.
- 29 WEFO has generally effective financial management systems, including a series of 'management verifications', to ensure compliance and to detect errors before project expenditure is declared to the European Commission. Grant claims are scrutinised by WEFO's payments team and subject to independent external audit. WEFO's Project Inspection and Verification (PIV) team reviews sponsors' systems of financial

control and inspects project expenditure. WEFO itself is subject to audit by the Audit Authority (the Welsh Government's European Funds Audit Team – EFAT) and the EU's own auditors. The irregularity rate in expenditure declared to the European Commission has been well below the two per cent level that is the maximum accepted by the European Commission. However, as noted in [paragraph 6](#), the Audit Authority is currently in the process of recalculating error rates to meet the European Commission's revised requirements, although the indications are that these remain low overall.

30 Compliance and audit requirements can impose a heavy administrative burden on project sponsors and there is a significant degree of overlap between audit functions. Whilst this situation is largely unavoidable because each function is required by EU regulations, there is some scope for WEFO to coordinate this work to reduce overlap.

31 **Performance is better managed than under the previous programmes but could be tighter in some respects.** WEFO monitors the progress of projects after approval through the quarterly grant claims and progress reports, which all projects are required to submit, and regular meetings with sponsors at which any problems or significant issues can be discussed. Our review of project files indicated that these review meetings were not always held regularly and the reasons for delays in project implementation were not always clear from the files. Nevertheless, performance management is tighter than under the previous programmes, and is facilitated by the smaller number of projects. WEFO has withdrawn funding from projects that have not performed as well as expected, a process that is easier than it was under the previous programmes because many projects are managed by the Welsh Government.

32 **WEFO has strengthened monitoring and evaluation arrangements and developed more robust approaches to measuring impacts, but data quality remains a concern.** WEFO's Research, Monitoring and Evaluation (RME) team collates and reports monitoring data, organises programme level evaluations and advises projects on evaluation. There is a set of coherent, well-defined monitoring indicators. The 'gross jobs created' indicator, however, does not fully capture all the employment effects because it excludes safeguarded jobs, temporary posts and project administration jobs. There has also been variable progress in measuring 'soft outcomes' to capture the impact of activities designed to develop personal attributes among those at risk of exclusion from the labour market.

33 WEFO has introduced controls and guidance to improve the often poor quality of data in the previous programming round. However, concerns remain about data quality at the participant level and double counting of outcomes between projects.

34 WEFO's evaluation plan builds on experience with the previous programmes. A series of interim thematic evaluations is nearing completion and, with interim project evaluations, will inform the design of the 2014-2020 programmes, although it is too early to assess the impact of most projects at this stage. WEFO has developed a more sophisticated approach to measuring net impact using the Labour Force Survey and the business datasets held by the Office of National Statistics to develop control groups with which the results of the programmes can be compared. This approach has worked quite well for the ESF programmes, but poor data quality and the limited scope of the business datasets has prevented the ERDF Business Survey from building reliable control groups.

Recommendations

- R1 Some sponsors were unclear initially about the project selection process and expected a shorter process than WEFO believed was realistic. To help ensure that expectations are more closely aligned at the outset for future programming rounds, **we recommend that WEFO publishes guidance that explains the content, purpose and likely duration of each step of the process leading up to project approval, indicating the most common causes of uncertainty and delay and how such problems may be averted or mitigated. The guidance should set out the responsibilities of both the sponsor and of WEFO for ensuring that the process runs smoothly and with minimal delay.**
- R2 Uncertainty about permissible delivery models (for example, procurement versus direct delivery) caused disruption and delay to the progress of some applications. Some sponsors were unprepared for the switch to a procurement-led approach and lacked the expertise to run an effective procurement exercise. **We recommend that:**
- a **WEFO specifies its policy on delivery models (and procurement more specifically) at the outset of the next programming round, making any changes to the current policy in consultation with stakeholders while the operational programmes are being developed, and subject to any changes required by the Commission.**
 - b **WEFO reviews the capacity of project sponsors to run effective procurement exercises and builds capacity where appropriate. This may include the provision of procurement expertise to a wider range of sponsors using technical assistance (only voluntary bodies currently benefit), training and dissemination of good practice.**
- R3 The Welsh Government's strategic framework documents have helped WEFO to assess applications but they have been of more limited value for applicants and have not been used proactively to monitor progress or develop actions to fill gaps in service delivery. For the 2014-2020 programmes, WEFO's proposals for an alternative *Economic Prioritisation Framework* that is regularly updated will help address this issue. **We recommend that:**
- a **strategic guidance (in the form of the Economic Prioritisation Framework or otherwise) should be as specific as possible about types of activity, target beneficiaries and delivery approaches, including relative priorities, whilst recognising the constraint that specific projects cannot be guaranteed funding unless and until they have gone through the appraisal process and been approved; and**
 - b **the guidance is updated regularly, with an emphasis on identifying actions to exploit any new opportunities or to address problems or gaps in delivery.**
- R4 The scope for simplifying the process is limited by the need to maintain a process that meets EU requirements and ensures that proposed operations are supported by clear, robust and credible delivery plans. **We recommend that:**
- a **WEFO make no major changes to the current process, but consider opportunities to simplify or clarify certain aspects of the process as part of its work to develop the 2014-2020 programmes;**
 - b **publish guidance in good time for the launch of the next programming round so that applicants have access to comprehensive guidance from the outset; and**

- c **make guidance as specific as possible, to avoid complaints about ambivalent guidance and inconsistent application by PDOs.**

R5 The duration of the project development process was a major concern of project sponsors. We recognise that each project will be different and a standard timetable may not be appropriate. However, **we recommend that a clear understanding is agreed with project sponsors at the outset of project development so that each party knows what is required of them by when, and that the key milestones in project development are monitored by WEFO so that allegations of undue delays can be investigated.**

R6 There were some problems mobilising the programmes in 2008 and 2009. Timely mobilisation is necessary to ensure a smooth transition between programming periods and to help meet spending targets. We endorse WEFO's proposals, acting on the Guilford Review, to introduce a mobilisation phase for the 2014-2020 programmes that will require sponsors to set aside time to establish delivery mechanisms, for example to select contractors. **We recommend that:**

- a **work begins before the new programmes are launched on developing key 'strategic' projects, with the aim of approving them as soon as possible of the approval of the operational programmes; and**
- b **WEFO require the timetable for project delivery to include key milestones for the mobilisation and delivery phases, and uses this timetable to challenge and amend unrealistic timescales, which often underlie over-optimistic spending profiles.**

R7 WEFO has already strengthened the monitoring of outputs and results compared with the last programming round and has improved its approach to evaluating impact. To further strengthen these arrangements, **we recommend that:**

- a **Given the fact that most ESF programme targets have been exceeded by a wide margin, targets for the new programming round should be set at a challenging but realistic level based on current economic conditions and experience to date in the current programming round.**
- b **For the next round of ESF programmes, the definition of an unemployed participant should be aligned with that used by the Labour Force Survey. Currently the ESF programmes only count Jobseeker's Allowance claimants as unemployed, but this tends to over-state the extent to which the programmes are targeting the most disadvantaged, economically inactive population.**
- c **WEFO replaces the 'profit benefit' monitoring indicator with one that is more clearly defined and easier to measure, such as increase in turnover or cost reduction arising from EU funding.**
- d **WEFO should strengthen its focus on monitoring output targets to ensure that output targets, including the distribution of outputs between target groups and geographical areas where appropriate, are agreed and monitored by all project sponsors at regular intervals.**

- e **Programme monitoring reports should include full explanations of any significant variations from expected figures, including significant shortfalls in the proportion of participants from disadvantaged groups or other evidence of potential gaps in project delivery. The Committee should discuss progress against output and result targets for each programme at least annually and recommend any actions to address any shortfalls.**
- R8 A large proportion of programme funding is delivered through procured contracts, which have the potential to benefit companies based in Wales, especially small and medium-sized enterprises. WEFO does not collect information on the value of contracts awarded to SMEs and Welsh-based companies. Such information would be helpful in order to evaluate the impact of programme delivery on the Welsh economy. **We recommend that WEFO monitor the value of contracts awarded to Welsh-based companies and SMEs.**
- R9 Project sponsors are subject to a rigorous audit and inspection regime that has successfully kept error rates relatively low. However, the system can be burdensome for sponsors. **We recommend that, for the 2014-2020 programming rounds, WEFO review the scope of each element of the audit and inspection regime with a view to removing unnecessary duplication, coordinating work to develop a risk-based approach as far as practicable, and building on its existing preventive work.**
- R10 WEFO has found it problematic to obtain participant level data of acceptable quality from project sponsors on a timely basis, especially for ERDF projects, and this has hampered ERDF evaluation efforts. Procurement data is also incomplete. **We recommend that WEFO:**
- a **more rigorously enforce data quality standards so that sponsors provide timely, accurate and complete information on participants and businesses; and**
 - b **consider replacing the provision of participant data on spreadsheets with an interactive database whereby sponsors enter data directly in a prescribed format, thus improving the quality of data submitted, reducing the risk of duplicate outcomes and reducing administrative costs for WEFO.**
- R11 The 2011 ERDF Business Survey, which is being repeated in 2014 had relatively high refusal and non-recall rates (businesses that could not remember even receiving assistance). To improve data quality, **we recommend that WEFO undertake the ERDF Business Survey on an ongoing basis, perhaps at a specified interval after the completion of support for a particular business, with periodic reporting of results to provide evidence of impact.**

R12 Most project evaluations are commissioned independently by project sponsors, and there is limited collaboration between sponsors or links with other evaluations that might provide good evidence of emerging impacts. **We recommend that WEFO:**

- a **Enable project sponsors to use data relating to their projects from programme wide evaluations (especially the ERDF Business Survey and the ESF Leavers' Survey) for project evaluation wherever appropriate (ie, subject to relevance and to data protection and security requirements).**
- b **Encourage and assist sponsors of similar projects or activities to commission joint evaluations or to collaborate on methods and good practice where a single evaluation would not be appropriate. In particular, WEFO should seek a common approach to evaluating soft outcomes, employment effects and other key impact indicators for the main programme themes, and ensure that such information is collected on an ongoing basis to inform project and programme management.**

Part 1

Wales and the European Union Structural Funds



1.1 EU Structural Funds help finance a range of measures to support job creation, competitiveness, economic growth, improved quality of life and sustainable development. Structural Funds form part of EU regional policy and support three main objectives: Convergence; Regional Competitiveness and Employment; and Territorial Cohesion (**Exhibit 3**). However, most of the Structural Funds budget for 2007-2013 is directed towards the Convergence objective of reducing economic disparities between EU regions.

1.2 This part of the report outlines the main features of EU Structural Funding for the 2007-2013 programming period (1 January 2007 to 31 December 2013) and how it applies to and works in Wales. The seven-year timeframe for Structural Funds programmes allows longer-term planning and budgeting than is commonly the case with domestic expenditure. Planning for 2007-2013 began around 18 months before the start of the period and expenditure will continue for up to two years after the end of the period, followed by a process of review and audit by the European Commission.

Wales stands to benefit from around £1.9 billion of EU Structural Funding for the 2007-2013 period, mainly for West Wales and the Valleys

1.3 Structural Funding in Wales is distributed through two funds:

- a The *ERDF* accounts for 60 per cent of the available funding. The ERDF aims to correct imbalances between the economic prosperity of member states by:
 - Research, Development and Innovation (RD&I) – building business capacity to develop and take up improved and new products, processes and services;
 - funding infrastructure linked particularly to regeneration, telecommunications, environment, energy and transport; and
 - finance – repayable and non repayable grants to support jobs and growth.
- b The *ESF* accounts for 40 per cent of the funding. The ESF aims to promote employment in the EU by funding projects to:
 - help employers and employees adapt to changing economic demands through training schemes;
 - improve access to job opportunities, particularly for those, such as the long term unemployed, who are furthest from the labour market; and
 - encourage lifelong learning, innovation in the workplace and equal opportunities for all.

Exhibit 3 – EU regional policy objectives and the distribution of EU Structural Funds

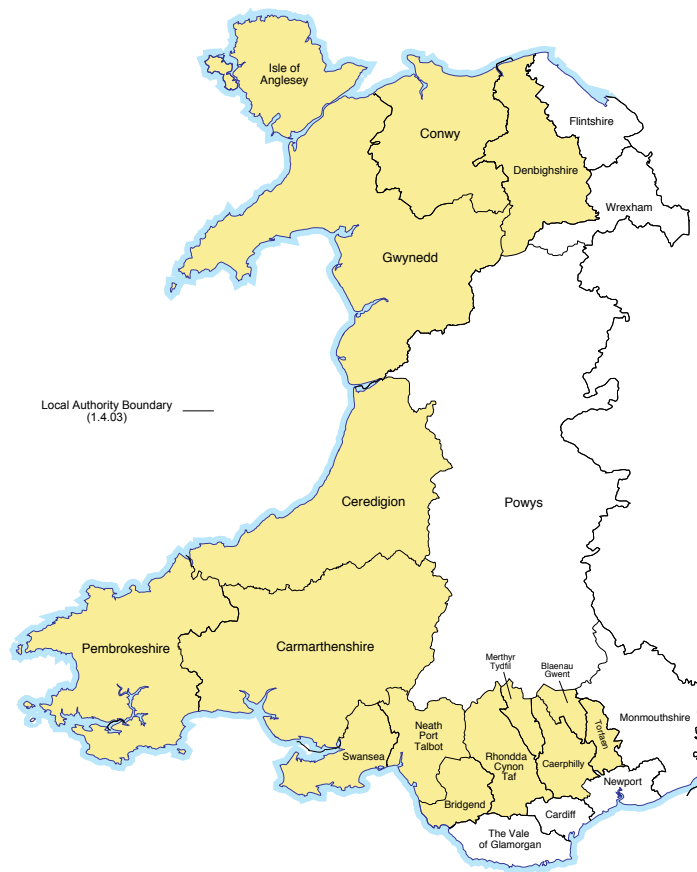
Policy objective	<ul style="list-style-type: none"> • Regional coverage • Population coverage • Percentage of EU Structural Funds budget allocated to the objective
<p>Convergence</p> <p>To reduce economic disparities between EU regions by enabling worse-off regions to catch up with better-off regions.</p> <p>Regions qualifying are those with a per capita GDP of less than 75 per cent of the EU average¹.</p>	<ul style="list-style-type: none"> • 99 regions • 170 million people • 81.5 per cent of budget
<p>Regional Competitiveness and Employment</p> <p>To create jobs by promoting competitiveness and making the regions concerned attractive to businesses and investors.</p> <p>Applies to all regions not covered by Convergence. Intended to help better-off regions perform even better, create more balanced development, eliminate remaining pockets of poverty and to have a knock-on benefit on the rest of the EU.</p>	<ul style="list-style-type: none"> • 170 regions • 330 million people • 16 per cent of budget.
<p>Territorial Cohesion</p> <p>To encourage cooperation across borders – be it between countries or regions – that would not otherwise happen. Initiatives could include the shared management of natural resources, development of transport links and creating networks of universities and research institutes. These cross-border programmes potentially cover all regions.</p>	<ul style="list-style-type: none"> • 269 regions • 500 million people • 1.5 per cent of budget

Note:

¹ GDP – the value of goods and services produced – is measured in a way that adjusts for the effect of price differences between member states.

Source: EU website

Exhibit 4 – The Convergence and Competitiveness areas for Structural Funding



1.4 Overall, Wales stands to benefit from some £1.87 billion of EU Structural Funding for the 2007-2013 programming period (as at 31 December 2013)⁶. There are two separate programmes (one for ERDF and one for ESF) for each of the following regions⁷:

a *West Wales and the Valleys* under the Convergence objective. The region covers 15 local authority areas, around 62 per cent of the land area of Wales and some 1.9 million people (Exhibit 4). The region will receive

around £1.76 billion of European funding for the 2007-2013 period – around 94 per cent of the total funding allocated to Wales.

b *East Wales* under the Regional Competitiveness and Employment objective. The region covers the better-off areas of Wales outside the Convergence region, with a population of just over one million, which will receive £115 million of European funding for the 2007-2013 period, around six per cent of the total available to Wales.

⁶ The value of the programmes in sterling fluctuates depending on the £/€ exchange rate. The pound fell from €1.47 to €1.02 between the approval of the ERDF programmes in August 2007 and the end of 2008, increasing the potential value of the Structural Funds by around 44 per cent or £670 million. There followed a rise in the value of the pound to around €1.20 at the end of 2012, reversing just under half of the previous gains. Throughout this report, euro figures have been translated into sterling at a rate of 1.20, which WEFO used for planning and reporting purposes at 31 December 2013.

⁷ Wales also takes part in, but is not the Managing Authority for, the Ireland-Wales cross-border programme, which encourages cooperation between the western areas of Wales and the south-eastern region of Ireland. The EU has allocated around £42 million to this programme for the 2007-2013 period, which is shared between the two countries. Wales may also bid for resources from the North-West Europe and Atlantic Coast programmes, which encourage transnational cooperation.

1.5 Each programme has a budget for EU funding alongside the required match funding from the public⁸ and private sectors. Including this match funding, the 2007-2013 Structural Funds programme is worth around £3.20 billion to Wales. The ratio of EU funding to match funding varies by programme (Exhibit 5).

Exhibit 5 – Structural Funding allocations for Wales, 2007-2013, by Programme and Fund

	EU grant (£ million) ¹	Match funding (£ million)	Total funding (£ million)	Grant rate (per cent)
ERDF Convergence	1,053	786	1,839	57%
ESF Convergence	703	391	1,094	64%
Convergence programmes	1,756	1,177	2,933	60%
ERDF Competitiveness	62	75	137	45%
ESF Competitiveness	53	80	133	40%
Competitiveness programmes	115	155	270	43%
Total for all programmes	1,871	1,332	3,203	58%

Note:

¹ Financial allocations based on position at 31 December 2013 using an exchange rate of €1.20 to £1.

Source: WEFO

⁸ Includes the voluntary sector.

Structural Funds programmes are planned to help deliver EU-wide policies on jobs, growth and sustainable development

- 1.6 Each programme is divided into priorities that relate to a particular social or economic objective, for example encouraging innovation or reducing economic inactivity. Each priority has its own budget (**Exhibit 6**), and priorities may be further divided into themes which have their own indicative (non-binding) financial allocations.
- 1.7 The European Commission agrees with the relevant authority in each member state operational programmes of work at the outset of the programming period⁹. In Wales, the relevant authority is the Welsh Government. Each operational programme:
- a reviews the economic and social situation in, and the needs, strengths and weaknesses of, the programming area;
 - b proposes a strategy to address the area's needs in line with EU strategic guidelines and domestic (in this case Welsh Government) policy;
 - c sets out an integrated programme of activities to deliver the strategy, organised into priorities with specific budgets (see **Exhibit 6** for Wales), monitoring indicators and output targets;
 - d explains how the programme will promote the cross-cutting themes of environmental sustainability and equal opportunities; and
 - e describes the administrative arrangements that will apply for the duration of the programme.

⁹ Approval of the operational programmes is the culmination of a process that takes around two years and includes the agreement by member states of the EU budget, publication of EU Structural Funds regulations, and European Commission acceptance of the UK Government's National Strategic Reference Framework, a document that sets out at a high level how allocated EU funds will be used and administered.

Exhibit 6 – Structural Funding allocations for Wales, 2007-2013, by Fund and priority

Priority name (<i>number</i>)	Allocation (£ million) ¹		Examples of activities funded
	EU grant	Total	
ERDF Programmes			
Knowledge and innovation <i>Convergence Priority 1</i> <i>Competitiveness Priority 1</i>	291	531	Support for research and development with likely commercial benefits, ICT infrastructure and support for business innovation
Business growth and competitiveness <i>Convergence Priority 2</i> <i>Competitiveness Priority 2</i>	138	267	Support for entrepreneurship, business finance (including venture capital funds)
Strategic infrastructure <i>Convergence Priority 3</i>	327	588	Road and rail projects, community transport, sites and premises for business
Creating an attractive business environment <i>Convergence Priority 4</i> Tackling climate change <i>Competitiveness Priority 3</i>	204	350	Renewable energy, energy efficiency, flood defence, tourism initiatives based on local heritage and the natural environment
Sustainable communities <i>Convergence Priority 5</i> Regeneration for growth <i>Competitiveness Priority 4</i>	141	220	Physical regeneration, community economic development
ESF Programmes			
Supplying young people with skills for learning and future employment <i>Convergence Priority 1</i>	104	159	Initiatives to tackle under-achievement in schools and raise skills and aspirations, eg, through mentoring, volunteering, work experience, career guidance and awareness raising
Increasing employment and tackling economic inactivity <i>Convergence Priority 2</i> <i>Competitiveness Priority 1</i>	302	501	Personal job search support tailored to individual needs, work placements, incentives for employers to employ and retain jobless individuals
Improving skills levels and the adaptability of the workforce <i>Convergence Priority 3</i> <i>Competitiveness Priority 2</i>	308	494	Basic skills training, apprenticeships, training at all levels, initiatives to challenge gender segregation in the workforce
Modernising and improving the quality of our public services <i>Convergence Priority 4</i>	28	46	Encouragement of collaborative working between public bodies, projects to build capacity of public bodies to provide better quality public services

Exhibit 6 – Structural Funding allocations for Wales, 2007-2013, by Fund and priority (continued)

Priority name (<i>number</i>)	Allocation (£ million) ¹		Examples of activities funded
	EU grant	Total	
ERDF and ESF			
Technical assistance (<i>one Priority in each programme</i>)	28	47	Bespoke IT systems to manage EU funding, research and evaluation, training for project managers, expert advice, support for partnerships and networks
Total	1,871	3,203	

Note:

¹ Financial allocations based on position at 31 December 2013 using an exchange rate of €1.20 to £1. The Competitiveness programmes fund a more limited range of activity than Convergence.

Source: WEFO financial data and operational programmes

1.8 Once approved, operational programmes may be modified to reflect significant changes in policy or in the economic context, but only with the approval of the Programme Monitoring Committee and subsequently the European Commission. In the 2007-2013 funding round, the operational programmes are complemented by a series of strategic frameworks that provide additional guidance on priorities and project design. These frameworks are developed by the Welsh Government and do not require specific authorisation by the European Commission (Exhibit 7).

Exhibit 7 – Strategic frameworks for the EU Structural Funds programmes in Wales

There are 20 strategic frameworks that cover all areas of programme activity and apply to both the Convergence and Competitiveness programmes (Appendix 2). Each framework is linked to specific priorities and themes within the programmes. Fifteen are thematic frameworks, dealing with specific policy areas such as climate change or business finance. Five are spatial frameworks that cover regeneration activity in specific geographical areas (Swansea Bay, Pembrokeshire, South East Wales, Central Wales and North Wales) that reflect the areas delineated in the Wales Spatial Plan.

Each of the thematic frameworks also has a section dealing with the spatial context – the main challenges and opportunities facing each of the spatial framework areas and the locations and groups that should be targeted.

The frameworks have a common format and cover:

- an outline of the main strategies, policies and EU initiatives that are relevant to the framework;
- the types of activity that will be funded under the framework (known as fields of intervention), their purpose and expected approaches to delivery;
- monitoring indicators and financial allocations;
- key principles and regulations, with reference to relevant guidance; and
- framework evaluation and review, including evaluation questions to be used for project evaluation.

- 1.9 All programmes are expected to deliver against the 'Lisbon Agenda' for jobs and growth, agreed by all member states in 2000 and reinforced in 2005 by the EU Growth and Jobs Strategy. European Commission strategic guidelines for the Structural Funds outline how member states should contribute to the three main objectives of the strategy:
- a **Make Europe a more attractive place to invest and work** by investing in transport infrastructure, renewable energy and energy efficiency. To strengthen synergies between environmental protection and economic growth, the strategic guidelines urge member states to invest in environmental protection infrastructure, waste management and regeneration, and also to develop the economic benefits of natural and cultural assets.
 - b **Encourage knowledge and innovation for growth** by increasing and better targeting investment in research and development, facilitating innovation and promoting entrepreneurship, promoting the information society, and improving access to finance for small businesses.
 - c **Create more and better jobs** by attracting and retaining more people in the labour market, improving the adaptability of workers and enterprises, and increasing investment in human capital through better education and skills. The Structural Funds will also invest in the administrative capacity of public services.
- 1.10 The EU requires each Convergence operational programme to devote 67 per cent of funding to specified activities that contribute most to the Lisbon Agenda, rising to 75 per cent for Competitiveness programmes. This requirement limits the ability of member states to use Structural Funding to finance non-preferred activities, for example general business advice or inward investment incentives.
- 1.11 The EU 'Europe 2020' strategy re-stated the commitment to jobs and growth and introduced a stronger emphasis on sustainable development, economic recovery and fiscal consolidation. The Structural Funds are expected to contribute to the five key targets of the Europe 2020 strategy, which are that, by 2020:
- a 75 per cent of all 16-64 year olds will be in employment;
 - b the EU will invest three per cent of its GDP in research and innovation each year;
 - c to mitigate climate change, the EU will have cut greenhouse gas emissions by 20 per cent since 1990, increased energy efficiency by 20 per cent and will obtain 20 per cent of electricity from renewable sources;
 - d for education, school drop-out rates will be less than 10 per cent and 40 per cent of 30-34 year olds will have completed third level (higher) education; and
 - e the EU will have 20 million fewer people in or at risk of poverty and social exclusion.
- 1.12 Reflecting these EU objectives and targets, the Welsh Government led programmes for 2007-2013 focus more on innovation and infrastructure than was the case in the 2000-2006 programming round.

The Structural Funds operate within a clearly defined framework of regulations and controls

- 1.13 The Structural Funds programmes are governed by EU regulations. These include specific regulations for each fund that determine eligible activities, expenditure, record-keeping and audit. General EU regulations on public procurement and state aid (government support for commercial enterprises) are also particularly important because projects funded by the programmes often involve the commissioning of services that have an international market or involve aid for particular enterprises. The programmes are subject to audit by several organisations including the European Court of Auditors, and irregularities may lead to the clawback of EU funding already paid to the member state.
- 1.14 The Structural Funds will only pay for activity that is genuinely 'additional' to that which would have been funded without EU support. The EU regulates additionality by agreeing with each member state a minimum level of domestic expenditure in the programming areas on the broad categories of expenditure (basic infrastructure, human resources and productive investment) that receive support from the Structural Funds. This level of expenditure must be maintained to demonstrate that the relevant authority has not used Structural Funds to replace public or equivalent structural expenditure.
- 1.15 The Structural Funds programmes are delivered through individual projects, of which there were 287 at 31 December 2013. Each project is led by one organisation, the 'project sponsor', which is accountable under contract (the Grant Offer Letter) to WEFO for managing and delivering the project in accordance with its business plan, relevant EU regulations, the Welsh National Eligibility Rules and the terms of the Grant Offer Letter. The project sponsor may be assisted by other 'joint sponsor' organisations. Most project sponsors are public sector organisations, often the Welsh Government itself. Ultimately the programmes' progress depends on the speed with which sponsors are able to plan and deliver their projects, but this in turn depends in large part on the support provided by WEFO.
- 1.16 The main bodies involved in the management of the Structural Funds for a particular region are:
- a The **European Commission** administers the Structural Funds for the EU and is responsible for:
 - allocating the overall Structural Funds budget between member states and programmes;
 - developing strategic guidelines for the use of the Funds;
 - approving operational programmes;
 - monitoring the progress of the programmes by reviewing annual reports and acting as observers at meetings of the Programme Monitoring Committee (see below);
 - authorising projects which exceed €50 million in EU grant; and
 - verifying compliance with regulations.
 - b The **Managing Authority** is accountable to the European Commission for delivering its programmes efficiently in accordance with the regulations governing the use of the Structural Funds. The Welsh Ministers act as the Managing Authority for the Welsh programmes, and responsibility is delegated to WEFO, a division of the Welsh Government. The Managing Authority is responsible for:

- selecting projects for funding in accordance with selection criteria and EU regulations;
 - ensuring that the programme as a whole makes good progress and is delivered in line with the operational programme;
 - paying EU grant to project sponsors based on claims for eligible expenditure and preparing requests for reimbursement from the European Commission;
 - undertaking verification checks on a sample basis to ensure that claims are valid and the underlying transactions are adequately documented;
 - monitoring and evaluating the programmes in line with an agreed plan;
 - communicating essential information to project sponsors and publicising the programmes more widely; and
 - preparing the annual implementation reports, annual control reports and the final reports required by the European Commission under EU regulations.
- c The **Certifying Authority** is responsible for checking claims for European funding from the Managing Authority, ensuring they are correctly stated and adequately supported, and submitting the claim to the European Commission. In Wales, WEFO acts as Certifying Authority, but the part of WEFO undertaking this task is functionally separate from the rest of the organisation to avoid a potential conflict of interest.
- d The **Audit Authority** is responsible for independently auditing the management and control systems for the Structural Funds, and auditing a sample of projects to ensure that expenditure claimed is correct and complies with the relevant regulations. The Audit Authority reports annually to the European Commission on the results of its work. It submits a closure declaration at the end of the programmes, assessing the validity of the Certifying Authority's application for the final payment to be released by the European Commission. The European Funds Audit Team is part of the Welsh Government's corporate governance team and acts as Audit Authority for the Welsh programmes.
- e The **Programme Monitoring Committee** is responsible for monitoring the effectiveness and quality of each programme. The Welsh Government has established a single committee to oversee all four of its programmes, comprising 14 representatives from the main stakeholder groups (including central government, local government and private business) and 10 appointed experts. The committee:
- agrees the strategic frameworks are fit for purpose as part of the criteria used to select operations;
 - examines and approves any proposals by the Managing Authority to amend the operational programmes which is then subject to the agreement of the European Commission ([paragraph 1.8](#));
 - monitors progress in delivering the programmes, in particular against the programmes' financial and output targets; and
 - considers and approves the annual and final reports required by the European Commission.

Part 2

The programmes have progressed relatively well overall despite certain difficulties, but it is too early to fully assess their overall impact



- 2.1 This part of the report considers the overall progress of the programmes, with particular regard to:
- a the allocation of funds to projects, known as programme commitment;
 - b levels of spending once funds have been committed, both at a programme level against the European Commission's spending targets¹⁰ and at a project level against project delivery profiles; and
 - c the performance of the programmes in delivering their intended outputs and outcomes.

Overall, WEFO has made good progress in committing available funds to projects

WEFO has achieved most of the annual commitment targets it set itself, with most programme areas now fully committed

- 2.2 WEFO could not commit any of the funds due to Wales until the European Commission approved the operational programme for each of the Convergence and Competitiveness programmes. That approval is the culmination of a process that is largely outside WEFO control. However, to ensure a smooth transition from one programme to the next, it is important to gain momentum from the earliest stage in the new programming period.

- 2.3 WEFO agreed its ERDF operational programmes with the European Commission in August 2007, eight months after the start of the programming period but earlier than many other operational programmes across the EU. The ESF programmes were approved in October 2007, in line with many others. WEFO had already established a Programme Monitoring Committee in May 2007 and started developing project selection criteria and guidance for applicants from the first half of 2007. This meant that key requirements for project development were in place by December 2007, including: agreed project selection and prioritisation criteria; guidance for applicants; a monitoring and evaluation plan; and the supporting Welsh Government strategic framework documents.
- 2.4 By March 2008, WEFO had already received 160 expressions of interest from project sponsors, of which 50 had progressed for more detailed assessment. European Commission officials responsible for overseeing the Welsh programmes told us that they were content with the speed with which the programmes were launched. Our survey of project sponsors indicated that progress was much slower than many sponsors expected, but WEFO believes this may be associated with expectations about the standards expected of project proposals.

¹⁰ The achievement of commitment and spending targets has been made more challenging by changes in the sterling/euro exchange rate that, overall, have increased the value of the programmes.

2.5 Targets set in the Operational Programmes assume a roughly equal commitment of EU funding in each year of the programmes. This commitment profile is an important early indicator of programme activity and is used to calculate the N+2 spending targets (paragraph 2.10), which the European Commission uses for control purposes. However, WEFO set its own commitment targets for each year between 2008 and 2012 (Exhibit 8). For 2009 onwards, these targets were more demanding than those set by the European Commission to help increase momentum and

minimise the risk of missing EU spending targets. In this regard, WEFO was learning the lesson from the 2000-2006 programmes, which experienced significant project slippage. Higher commitment targets were also part of a strategy to tackle the impact of the economic downturn, which included negotiating higher grant rates with the European Commission to make domestic match funding go further. In our view, this strategy – to bring forward commitment and maximise expenditure – was appropriate and helped WEFO exceed the formal European Commission targets.

Exhibit 8 – Cumulative commitment of EU funding compared with European Commission and WEFO targets, 2007-2013¹

	2007	2008	2009	2010	2011	2012	2013
Commitment targets²							
European Commission operational programme target	13%	27%	41%	55%	70%	85%	100%
WEFO internal target	n/a ³	20%	50%	75%	80%	100%	100%
Actual programme commitment							
ERDF Convergence	0%	22%	42%	74%	79%	103%	101%
ERDF Competitiveness	0%	28%	53%	61%	70%	103%	111%
ESF Convergence	0%	35%	66%	86%	90%	94%	101%
ESF Competitiveness	0%	28%	62%	100%	97% ⁴	101%	108%

Notes:

- 1 Figures are as at 31 December for each year and are based on the cumulative commitment over all previous years of the programming period, as a percentage of the total EU funding allocation at each year-end.
- 2 The European Commission and WEFO targets apply to each programme on an individual rather than aggregated basis.
- 3 WEFO did not set a target for 2007 because the operational programmes were not approved by the European Commission until August and October of that year and WEFO was not able to approve any projects until after programme approval.
- 4 A reduction in the proportion of programme funding that is committed can occur because funding is de-committed from projects.

Source: WEFO

2.6 WEFO was ahead of the Operational Programmes' profiles for programme commitment by the end of 2009 and has maintained this position since then. WEFO comfortably met its own ESF commitment targets for each year between 2008 and 2011 but fell short of its own more demanding ERDF targets¹¹. The shortfall for the ERDF Competitiveness Programme in 2011 was due to the priority area with the highest budget, knowledge and innovation, having committed only 44 per cent of the £27.5 million funding available.

2.7 Overall, the increase in commitment between 2010 and 2011 was much smaller than in previous years. This was partly because many areas were fully or almost fully committed and because funding was de-committed (withdrawn) from some projects. Notably, the Welsh Government undertook a major review of its economic development policy in 2010 which resulted in some projects being removed or scaled back to better fit the requirements of the new policy. This resulted in the de commitment of around £50 million in 2010 from the ERDF Convergence Programme¹². However, in March 2011, WEFO decided to close several areas of the ERDF programmes to new applications, primarily due to high levels of actual and potential commitment.

2.8 Commitment rates for the 2007-2013 programmes have exceeded those for the 2000-2006 programmes in all equivalent years of the programming period, especially in the third and fourth years¹³. At the end of 2013, commitment rates exceeded 100 per cent for all of the four programmes and nine of the 19 priorities had been fully committed. The priorities that were not fully committed accounted for only 2.8 per

cent of the total EU funding allocation for the ERDF programmes and 2.0 per cent for the ESF programmes. WEFO plans to over-commit the ERDF programmes by five per cent and the ESF programmes by 10 per cent to help ensure that the full amount of EU funding is drawn down even if projects under-spend or the pound weakens against the euro, releasing more EU funding at a late stage.

Working with other Welsh Government departments, WEFO has responded appropriately to address shortfalls in commitment

2.9 WEFO has monitored the amounts committed to different policy areas and progress has been discussed regularly with Ministers responsible for the relevant Welsh Government departments. While progress had been slow in some areas initially, WEFO and other Welsh Government departments have taken appropriate action to stimulate project development or to re-allocate funding. For example:

- a *Modernising and improving the quality of public services*: At September 2010, only 25 per cent of the £27.5 million ESF Convergence Programme funding available for this purpose had been committed. WEFO officials told us that they expected early progress to be slow because this priority was innovative and the Welsh Government wanted to maximise strategic impact rather than there being a proliferation of small-scale, localised projects. WEFO attributed delays to the varying pace of the partners whose collaboration was needed to develop project proposals and the revision of the strategic framework to reflect evolving Welsh

¹¹ WEFO would have met all of its own ERDF commitment targets between 2008 and 2010 had the exchange rate remained at the 1.48 euros to the pound level as at August 2007 (when the operational programmes were approved by the European Commission).

¹² There have been other, more modest, de-commitments from projects to reflect under-performance, efficiency savings, ineligible expenditure and, in some cases, a shortage of match funding. WEFO has since recycled the released money into other projects but there was a temporary impact on commitment levels.

¹³ The difference between the rate of commitment for 2000-2006 and 2007-2013 reflects, to some extent, the different nature of the two programming rounds. For 2000-2006, individual projects tended to be of lower value and shorter in duration. For 2007-2013 most projects are at least three years in duration with many lasting six years and involving significant sub-contracting of service delivery.

Government policy. WEFO worked with other Welsh Government departments and Public Services Management Wales to develop project proposals and the Welsh Government created a specific pot of match funding worth up to £1 million. By 31 December 2013 around 76 per cent of the available funds had been committed. However, WEFO considered it unlikely that enough projects of sufficient quality would come through to fully commit the remaining funding and, therefore, re-allocated £4.5 million to other programme areas.

- b *Climate change:* Around £141 million of EU funding has been allocated in the ERDF programmes to mitigate the impact of climate change through flood defences, energy conservation, renewable energy and waste management projects. There was slow progress initially because of the complexity of some projects and because anticipated private sector led projects did not materialise as the economic downturn made it hard to raise funding. In March 2011, following a change in EU regulations, WEFO was able to approve ERDF funding of £33 million towards the Welsh Government's Arbed project to promote energy efficiency and micro-generation in existing housing. WEFO has also now approved grants of £50 million to flood defence projects. As a result, 74 per cent of the indicative allocation had been earmarked by December 2013, albeit with a lesser emphasis on renewable energy than that originally envisaged. The Welsh Government has established a central fund, Ynni'r Fro, to help bring forward more local small-scale energy generation projects by providing grant or loan finance.
- c *ICT infrastructure and exploitation:* the ERDF programmes include around £101 million for this theme, of which only 54 per cent had been committed by May 2011. The Welsh Government is now implementing a major project – Next Generation Broadband Wales – to extend high-speed broadband services to all areas of Wales by 2020. The project will cost a total of £203 million of which £89.5 million will be provided by ERDF, making it the biggest EU-funded project. The development of the project has been time-consuming because of its size and complexity, the need for in-depth research to demonstrate market failure, and the requirement to obtain specific approval as a major project from the European Commission. The project has now been approved and will use all available funds in the relevant priorities of the ERDF programmes.

The programmes have met EU spending targets, despite the rate of expenditure overall being slower than forecast by project sponsors

WEFO has met all EU spending targets, ensuring no loss of funding to Wales

2.10 The European Commission has set annual spending (N+2) targets for each of the operational programmes in Wales. Each programme must spend its agreed annual budget allocation within two years of the end of the year for which it was allocated¹⁴. If a programme falls short of its spending target, the unspent balance is de-committed and will not normally be re-committed, meaning a permanent loss of funding.

2.11 Based on this two-year rule, the first spending targets should have related to the position at 31 December 2009. In 2010, to help managing authorities manage the adverse impact of the economic downturn on match funding, the European Commission decided to abolish the 2009 spending target and revised the targets for 2010-2015. The revised targets were significantly less demanding in 2010 and 2011. However, WEFO decided that it would still seek to meet the original targets and has mostly done so.

2.12 Like other UK managing authorities, WEFO met both the original and the revised spending targets for all four of its programmes in 2009, 2010 and 2011, mostly by a substantial margin (Exhibit 9). WEFO met all four of the revised targets in 2012 and 2013 but fell slightly short of the two original ERDF programme targets, and performance generally was closer to target as the targets became progressively more demanding.

Exhibit 9 – Expenditure of EU funds compared with European Commission targets, 2009-2013

Programme and year	Actual expenditure (£ million) ¹	Actual expenditure as a percentage of original target	Actual expenditure as a percentage of revised target ²
2009			
ERDF Convergence	74.5	110%	N/A
ERDF Competitiveness	15.8	403%	N/A
ESF Convergence	68.9	153%	N/A
ESF Competitiveness	5.3	154%	N/A

¹⁴ Spending target performance is based on claims for reimbursement made by WEFO to the European Commission. WEFO needs to have received and paid a valid project grant claim before it can include the related expenditure in its claim to the Commission. As a result, there can be a time lag of up to six months between expenditure happening 'on the ground' and the WEFO claim.

Exhibit 9 – Expenditure of EU funds compared with European Commission targets, 2009-2013 (cont)

Programme and year	Actual expenditure (£ million) ¹	Actual expenditure as a percentage of original target	Actual expenditure as a percentage of revised target ²
2010			
ERDF Convergence	206.7	101%	275%
ERDF Competitiveness	21.6	182%	393%
ESF Convergence	165.9	121%	260%
ESF Competitiveness	11.7	112%	239%
2011			
ERDF Convergence	337.7	106%	152%
ERDF Competitiveness	33.6	161%	220%
ESF Convergence	276.9	115%	157%
ESF Competitiveness	23.9	130%	178%
2012			
ERDF Convergence	483.6	97%	110%
ERDF Competitiveness	27.4	95%	104%
ESF Convergence	342.1	103%	115%
ESF Competitiveness	29.7	117%	131%
2013			
ERDF Convergence	637.2	97%	101%
ERDF Competitiveness	37.6	96%	103%
ESF Convergence	466.0	103%	110%
ESF Competitiveness	38.1	110%	118%

Notes:

¹ Figures are as at 31 December for each year and are based on the cumulative expenditure over all previous years of the programming period that is certified by WEFO as being eligible for reimbursement by the EU.

² N/A = Not Applicable. In 2010 the European Commission decided to abolish the 2009 spending target and revised all future targets.

Source: WEFO

2.13 Three factors have helped boost WEFO spending of EU Structural Funds:

- a The substantial increase in the average intervention rate at Priority level – the proportion of the total cost that is met by EU funding rather than match funding – that WEFO negotiated with the European Commission, from an average of 49.0 per cent to an average of 59.3 per cent for the four programmes. This change released an additional £187 million of EU funding by 31 December 2013.
- b Some retrospective funding of projects which were wholly or partially complete before they were approved by WEFO. There have been three wholly retrospective transport infrastructure projects under the ERDF Convergence Programme. These projects claimed a total of £12.1 million of retrospective grant. There have also been 10 other projects for which retrospective funding totalled more than £1 million or 25 per cent of the total grant.
- c Wales was one of the first EU regions to establish the JEREMIE and JESSICA financial instruments. These are investment funds that follow the same pattern across the EU and are intended to finance small businesses and urban development ventures on a commercial basis, generating returns that fund further investments. The European Commission pays all of the grant for these funds when the funds are first established (2009 for JEREMIE and 2010 for JESSICA), which boosted grant drawn down on the two ERDF programmes by £73.2 million.¹⁵

Project spending has been slower than forecast for a variety of reasons including general over-optimism, difficulties with procurement and staff recruitment and the impact of the economic downturn

2.14 Each project sponsor agrees with WEFO a delivery profile that sets out how much the project expects to spend and what outputs it expects to deliver in each three-month period of its lifetime. The agreed delivery profile and baselined business plan is cross referenced in the offer of grant which is signed by the sponsor. Since June 2010, WEFO has produced monthly reports comparing forecast spend against actual spend for each project. Until November 2013, WEFO considered that any project within 15 per cent of its profiled spend was proceeding broadly to plan, although this threshold has since been reset at five per cent as the programmes draw to a close.

2.15 There has been a consistent pattern of projects under-spending against their delivery profile. As at December 2013, around one in three projects in progress were still 20 per cent or more behind their expenditure profile ([Exhibit 10](#)). While the overall shortfall between actual and forecast spending fell from 31 per cent in June 2010 to 19 per cent in December 2013, much of that improvement is due to project sponsors updating their delivery profiles to reflect major slippage, rather than catching-up with their original profiles. Many projects have stuck more closely to their expenditure profile once they have resolved difficulties in the start-up phase. Generally, WEFO permits sponsors one major re-evaluation.

¹⁵ The JESSICA project was cancelled in December 2013 and the £25 million of grant it received was withdrawn from the ERDF programmes at that time, affecting performance against the 2013 N+2 target. However, the money still counted against previous N+2 targets

2.16 The overall 19 per cent shortfall at December 2013 represented potential project expenditure worth £411 million, of which about £212 million was EU funding. At that point, the programmes had paid out to sponsors around £1.09 billion (58 per cent of the total EU funding allocation) compared with £1.55 billion (69 per cent) at the same stage of the equivalent 2000-2006 programmes.¹⁶

2.17 The level of project spending against profile is consistent with the pattern in the previous programmes. The level of expenditure forecast by project sponsors is well above the minimum levels required to meet EU spending targets. Based on project forecasts, WEFO estimates that it will meet all the 2014 spending targets, by a comfortable margin for three of the four programmes, and has classified programme expenditure as 'green' in its reports to the

Programme Monitoring Committee. Nevertheless, any under-spending against profile implies that benefits flowing from projects will not feed through to the Welsh economy as quickly as expected. WEFO officials have asked all partners involved in the delivery of projects to focus on timely provision of services to help achieve delivery of the programmes as planned.

2.18 As at 31 December 2013, the level of slippage tended to be higher for capital projects, which typically carry a higher element of financial risk, and for some innovative projects such as those for modernising public services. However, ERDF projects designed to encourage innovation and ESF projects aimed at preparing young people for the labour market have improved their performance overall as the programmes draw to a close. Slippage has been relatively low throughout the programming period for more established

Exhibit 10 – Actual project expenditure compared with profiled expenditure, June 2010 and December 2013¹

	December 2013
Overall expenditure shortfall against profile (<i>all projects in progress</i>)	19%
Breakdown of project performance (<i>percentage of projects in each banding</i>):	
Red: Project is 20% or more behind its expenditure profile	36%
Amber: Project is 6–19% behind or more than 5% ahead of its expenditure profile ²	34%
Green: Project is within 5% (ahead or behind) of its expenditure profile	30%

Notes:

- 1 The analysis in this table is based on actual project expenditure compared with profiled expenditure at 31 December 2013. The analysis includes all projects that were not financially completed at the relevant dates; it therefore excludes investment funds, new projects that had not yet claimed any grant, and completed projects.
- 2 Twenty of 241 projects were over-profile at 31 December 2013, of which eight were over profile by more than five per cent.

Source: Wales Audit Office analysis of WEFO payment statistics

16 Equivalent programmes defined as Objective 1 ERDF, Objective 1 ESF, Objective 2 (excluding transitional funding) and Objective 3. These programmes are broadly comparable with the ERDF Convergence, ESF Convergence, ERDF Competitiveness and ESF Competitiveness programmes respectively. The amount paid out to project sponsors will not reconcile to the amounts claimed from the European Commission over the same period due to timing differences, and because intervention rates for approved projects may be different from the standard intervention rates used by the European Commission when paying Structural Funds to member states.

areas of the programmes such as measures aimed at reducing economic inactivity and for Welsh Government programmes that continued from the previous programming rounds, such as Modern Apprenticeships and Business Start-up Support.

- 2.19 The reasons for slippage were not always clear from the files for the sample of 36 projects we reviewed. However, common themes included:
- a *Procurement difficulties*: Some project sponsors struggled to adapt to new competitive procurement requirements that WEFO introduced for the 2007 2013 programmes and under-estimated the time needed to establish the necessary procedures. Procurement was cited as a source of delay for nine of the 36 projects that we examined and these issues had a significant impact on some major projects during 2009 and 2010. The main problems seem now to have been overcome after WEFO reviewed its approach and modified its guidance on delivery models.
 - b *Staff recruitment difficulties*: Thirteen of the 36 projects that we examined identified staffing difficulties, particularly recruitment, as a reason for delays. In many cases, it appeared that projects simply under-estimated the time needed to recruit for key posts and to fully staff new or large projects. In other cases, sponsors had specific problems finding candidates with the right skills and experience. For the Welsh Government, staff turnover arising from restructuring and from voluntary severance, has made it difficult to maintain continuity and has led to gaps in project teams.

2.20 Other, less commonly cited issues were:

- a *Lower than expected demand for project services*: arising, for example, from the impact of the economic downturn on demand for business advice and policy changes leading to changes in the market for renewable energy.
- b *Availability of match funding*: a few projects reported that a shortfall in match funding for joint sponsors or grant applicants had hindered the progress of one or more elements of their project.
- c *Delays in project approval*: which caused a few education sector projects to miss the start of the academic year. Some delivery agents proceeded at their own risk while awaiting project approval, but others started their activities a year later than originally planned.

2.21 Overall, and as in the previous programmes, there also appears to have been an inherent over-optimism in sponsors' delivery profiles. Project delivery profiles do not set out the assumptions made at the outset about milestone dates for key tasks such as recruiting staff and issuing contract notices. In the absence of such information, it is difficult for WEFO staff to assess the realism of business plans and we found no evidence that they had challenged expenditure profiles even where subsequent progress indicated that they were unrealistic. WEFO intends to introduce a 'mobilisation phase' for the 2014-2020 programmes, whereby projects will have a specific period to establish their delivery mechanisms before delivery 'on the ground' is expected to occur. If planned realistically, the mobilisation phase should help to reduce optimism bias in delivery profiles.

The programmes are on track to meet, and in some cases far exceed, most of their key performance targets but are likely to fall short of most of their environmental sustainability and equal opportunities targets

WEFO focuses on between eight and 14 key performance indicators to monitor the delivery of each of the operational programmes

2.22 In 2007, WEFO agreed with the European Commission a series of monitoring indicators for each of the four operational programmes. These indicators reflect the main strategic objectives of the EU and those of the Welsh Government. The monitoring indicators fall into two categories:

- a *output indicators* reflect the activities undertaken by a project, such as the number of enterprises assisted or the number of participants in a training programme; and
- b *results indicators* are the immediate effects of a project and reflect its key aims, for example job creation or the achievement of specific qualifications.

2.23 WEFO uses other indicators to measure the wider overall impact of the programmes. Impacts usually occur over the long term, are more difficult to measure than outputs and results, and are assessed through evaluation at a programme rather than project level.

2.24 There are over a hundred monitoring indicators altogether, covering the four operational programmes and their respective priorities. However, WEFO focuses on between eight and 14 key output and results indicators to monitor the delivery of each operational programme. Of these, six key 'dashboard indicators' – jobs created, enterprises assisted, enterprises

created, participants assisted, participants gaining qualifications and participants entering employment – form the basis of WEFO's performance reporting as part of the Welsh Government's wider performance management arrangements. The two ERDF programmes share several of the same key indicators, likewise the two ESF programmes.

2.25 Most of the programme and priority level indicators have targets. The targets were set at the start of the programming period based on economic conditions and assumptions at that time about the scale and shape of the programmes (although some targets have since been changed, as has the definition of certain indicators). WEFO provides regular progress reports to the Programme Monitoring Committee, based on returns from project sponsors. **Appendices 3 and 4** describe the overall performance of each of the four operational programmes as at 31 December 2013 and as forecast at that point for the end of the programmes.

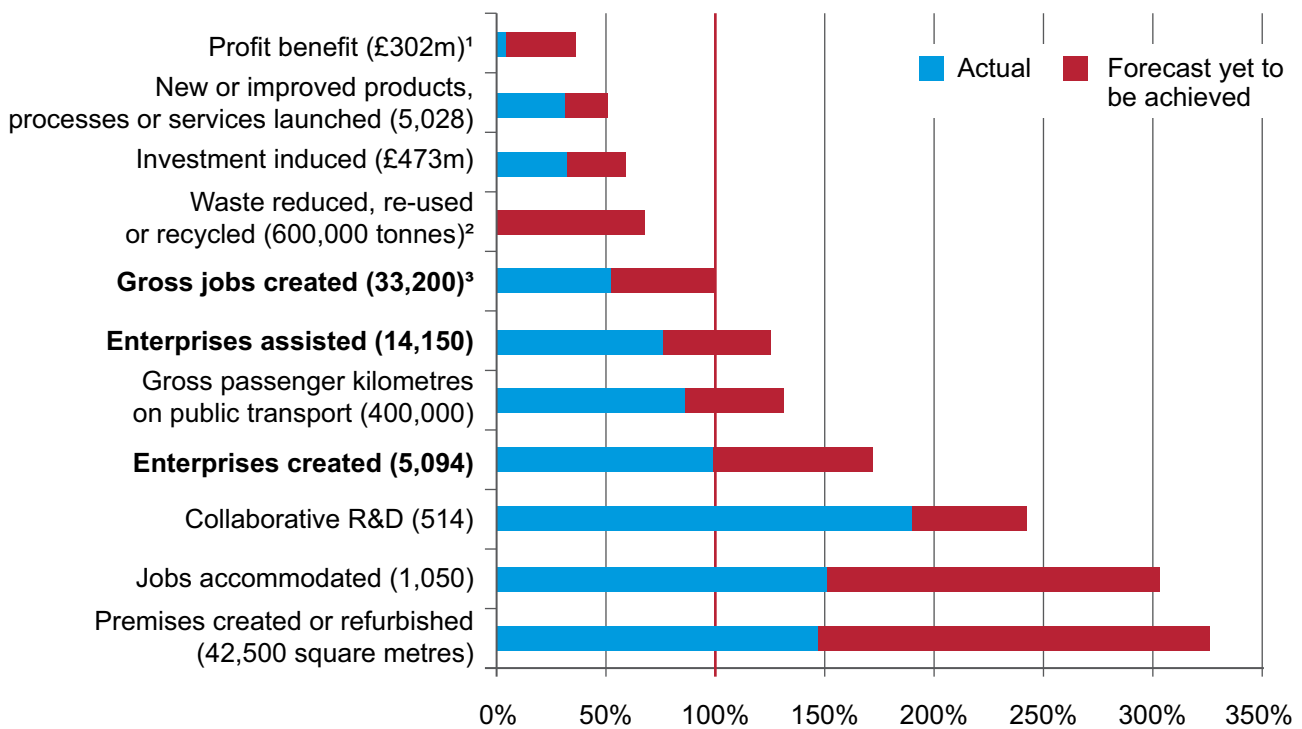
WEFO expects to meet most key ERDF targets, thanks in part to the increase in the programmes' value because of changes in the exchange rate which have helped to offset the impact of the economic downturn

2.26 The position reported by project sponsors as at the end of 2013 – covering both actual performance to that point and forecast outcome – indicates that WEFO would meet six of its 11 programme level targets for the ERDF Convergence Programme and five of the eight programme level targets for the ERDF Competitiveness Programme (**Exhibit 11**). Several of these targets have already exceeded, or are forecast to exceed, targets by large margins. For example, the Competitiveness Programme has already reported five times as many enterprises created as targeted.

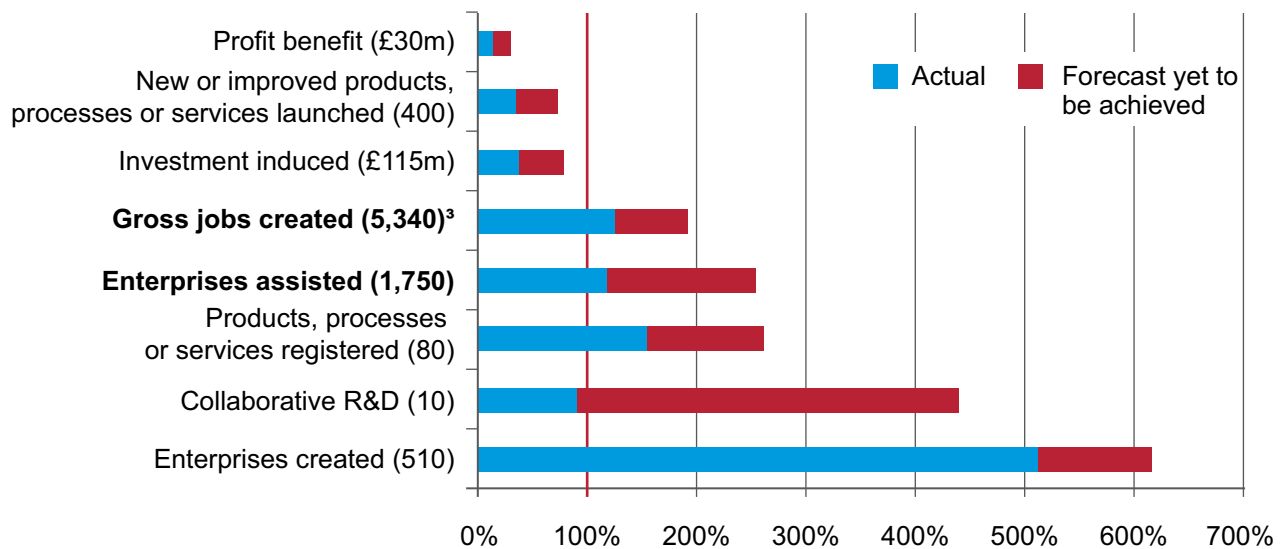
Exhibit 11 – Actual and forecast performance against ERDF Programme targets at 31 December 2013

The graph shows forecast performance to the end of the programming period for each indicator as a proportion of target. Blue shows actual performance. Red indicates the balance of the forecast that was yet to be achieved at 31 December 2013. The 100% mark indicates the target; dashboard indicators (paragraph 2.24) are shown in bold. The target measure is shown in brackets next to each indicator. Figures are based on project sponsors' returns received by WEFO as at 31 December 2013.

Convergence Programme



Competitiveness Programme



Notes:

- 1 'Profit benefit' is the amount of increased profit enterprises make from savings or productivity benefits, which have resulted from Structural Fund assistance or financial support.
- 2 The target for waste reduced, re-used or recycled has been reduced from one million tonnes to 600,000 tonnes.
- 3 'Gross jobs created' is the number of jobs achieved through ERDF support. Both new and associated jobs (such as construction jobs for capital projects) are included but project administration jobs are excluded. WEFO has updated the definition of 'gross jobs created' to include fixed term appointments of more than one year. WEFO believes that the revised indicator better reflects the current labour market and this has led to a considerable increase in the number of jobs reported to have been created. The targets for job creation remain unchanged.

Source: WEFO

- 2.27 The end of 2013 forecasts indicate that all but one of the ERDF related dashboard indicator targets would be met. However, the achievement of the job creation target for the ERDF Convergence Programme is likely to be particularly challenging, despite a change in measurement which has increased the number of jobs reported. At the end of 2013, the ERDF Convergence Programme had assisted around 10,700 enterprises and helped to create around 5,000 new enterprises and 17,000 new jobs for £1.18 billion of total programme expenditure (including match funding). The ERDF Competitiveness Programme had assisted 2,000 enterprises and helped to create about 2,600 new enterprises and 6,600 jobs for £117 million of total programme expenditure.
- 2.28 The six indicators that would fall significantly short of targets, based on the end of 2013 forecasts, relate to the following four themes:
- a *Investment induced*: project forecasts indicate that the ERDF Convergence Programme will deliver £277 million of private investment (58 per cent of the £473 million target). The economic downturn has made it more difficult to raise private finance than expected. WEFO does not intend to change this target. The Competitiveness Programme is expected to exceed its lower target for investment induced.
 - b *New or improved products, processes or services launched*: WEFO has received feedback that, due to the economic downturn, firms were spending longer in the development phase until they become confident that their new product, process or service would be a commercial success. Despite some improvement since the end of 2011, project forecasts indicate that the Convergence Programme will fall about 50 per cent short of its target. However, research and development activity appears to be progressing well, based on performance against the target for new products, processes, and services registered with the UK Intellectual Property Office¹⁷.
 - c *Waste reduced, re-used or recycled*: there has been a lack of demand for waste reduction projects as much of the large scale waste minimisation infrastructure was put in place under the previous 2000-2006 Objective 1 Programme. The change in emphasis in the current programmes from recycling to waste reduction in small and medium size enterprises has affected performance. While the European Commission has already agreed to reduce the Convergence Programme target from 1 million to 600,000 tonnes, project forecasts indicate that only 68 per cent of this 600,000 tonnes target will be delivered.
 - d *Profit benefit*: project sponsors are forecasting that they will achieve only 36 per cent of the Convergence Programme target and 29 per cent of the Competitiveness Programme target. The target is intended to capture increases in profits arising from savings or productivity benefits achieved with EU support. WEFO believes that the economic downturn has had an impact, but there is also a major measurement issue, with beneficiaries finding it difficult to attribute and calculate profits to specific EU-funded services. WEFO intends to leave the targets unchanged and to explore this issue through evaluation. WEFO has not prescribed any particular method for calculating profit benefit.

¹⁷ Registrations precede product launches, as the intellectual property created needs to be developed into a commercial proposition before a product can be launched.

- 2.29 The value of total funds committed at 31 December 2013, including match funding, is 12 per cent higher than the original programme allocations for the ERDF Convergence Programme and 38 per cent higher for the Competitiveness Programme. The increase in the programmes' value has made it easier to achieve the programme level targets, offsetting some of the negative effects of the wider economic downturn. Had WEFO increased its programme targets in line with commitment levels then, based on project sponsors' forecasts at 31 December 2013, the ERDF Convergence Programme would still meet six of its 11 targets, but would only achieve 85 per cent of expected job creation. The ERDF Competitiveness Programme would fall short of four of its eight targets including gross jobs created.
- 2.30 At 31 December 2013, the actual performance at that time was behind forecast for 10 of the 19 ERDF programme indicators. Delays in project delivery and resultant under-spending are likely to be a factor and there can also be a significant time lag in the collation of performance information from sponsors and their contractors compared with evidence of project expenditure. Nevertheless, the ERDF programmes would meet the same programme level targets if the same level of slippage continued until the end of the programmes.
- 2.31 Sitting below the programme level indicators, there is mixed performance at a priority level, again due in part to the particular impact on certain priority areas of changes in economic conditions, policy changes (including State Aid rules) and differences in the distribution of funding compared with initial assumptions. For example, transport funding has been focused on road schemes rather than rail schemes to a greater extent than expected, meaning that rail targets are unlikely to be met.
- 2.32 Following a review in 2010, WEFO revised some of its priority-level targets. Only three of the targets were reduced while 23 targets were increased, some by a substantial proportion. WEFO also introduced three new targets to cater for new tourist destination marketing activity. Overall, based on project sponsors' forecasts at 31 December 2013, 72 of the 125 priority-level targets would be met.
- The ESF programmes have performed strongly and are forecast to exceed their key performance targets, many by a substantial margin**
- 2.33 The ESF programmes depend substantially on large and relatively well-established national schemes and have not suffered from the difficulties with state aid, capital projects and policy changes that have affected parts of the ERDF programmes. As a result, the ESF programmes have progressed more smoothly. In addition, the economic downturn has also created more demand for the training and employment support services that comprise the bulk of ESF programme expenditure and the increasing value of the programmes has again made it easier to achieve programme targets.
- 2.34 At the end of 2013, the ESF Convergence Programme had supported 423,430 participants in training and employment support programmes for total programme expenditure (including match funding) of £779 million. The ESF Competitiveness Programme had helped 64,112 participants for total expenditure of around £98 million.¹⁸

¹⁸ Expenditure claimed by projects, not expenditure claimed by WEFO from the European Commission.

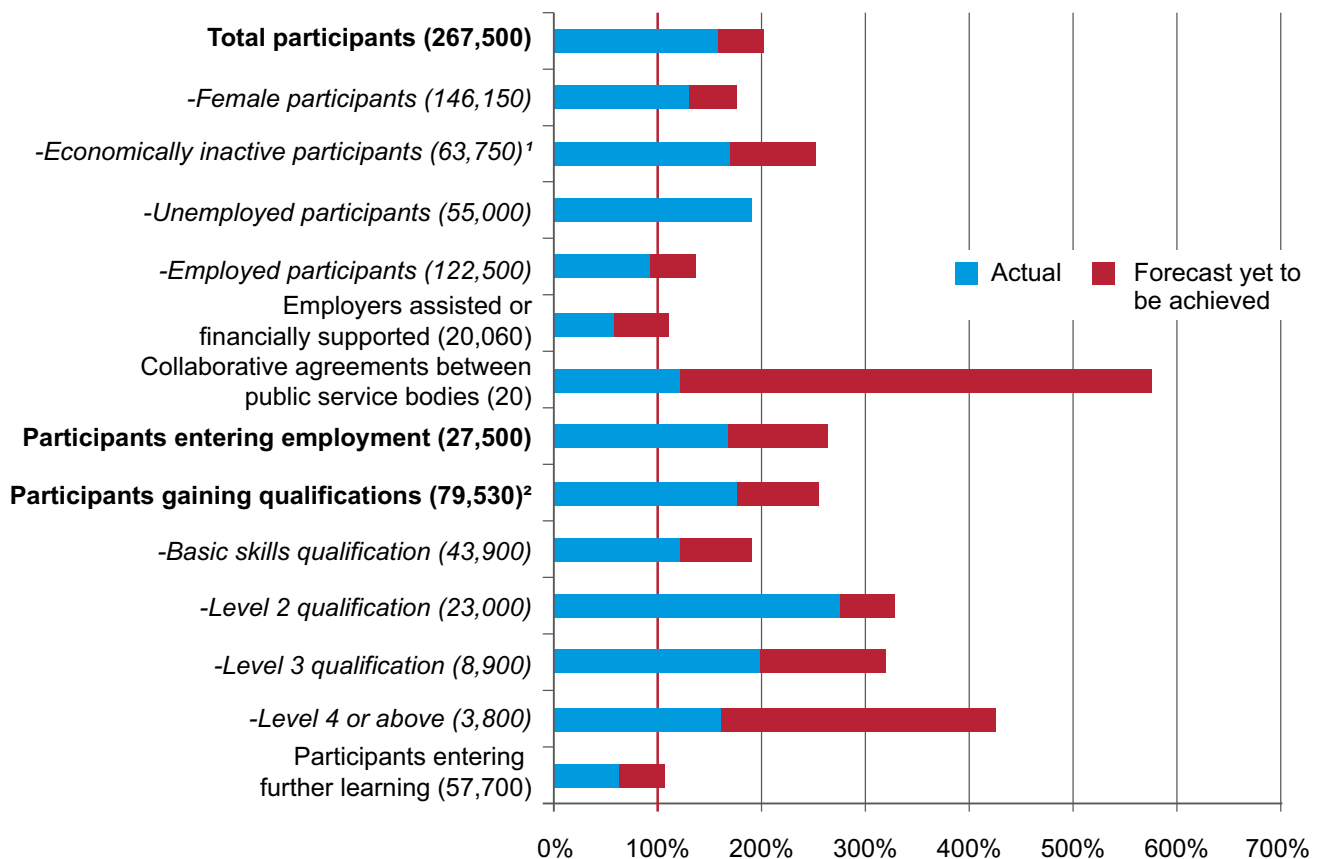
2.35 Project sponsor forecasts at 31 December 2013 indicate that all 27 of the original ESF Programme level targets will be met, many by a substantial margin (**Exhibit 12**). Twenty-two of the 27 targets are already reported to have been met and, overall, around twice as many participants as originally expected are likely to participate in the

programmes. The Competitiveness Programme is performing particularly strongly, and is also forecast to exceed all but one of its 21 priority-level targets. The Convergence Programme is forecast to exceed 30 of its 41 priority-level targets.

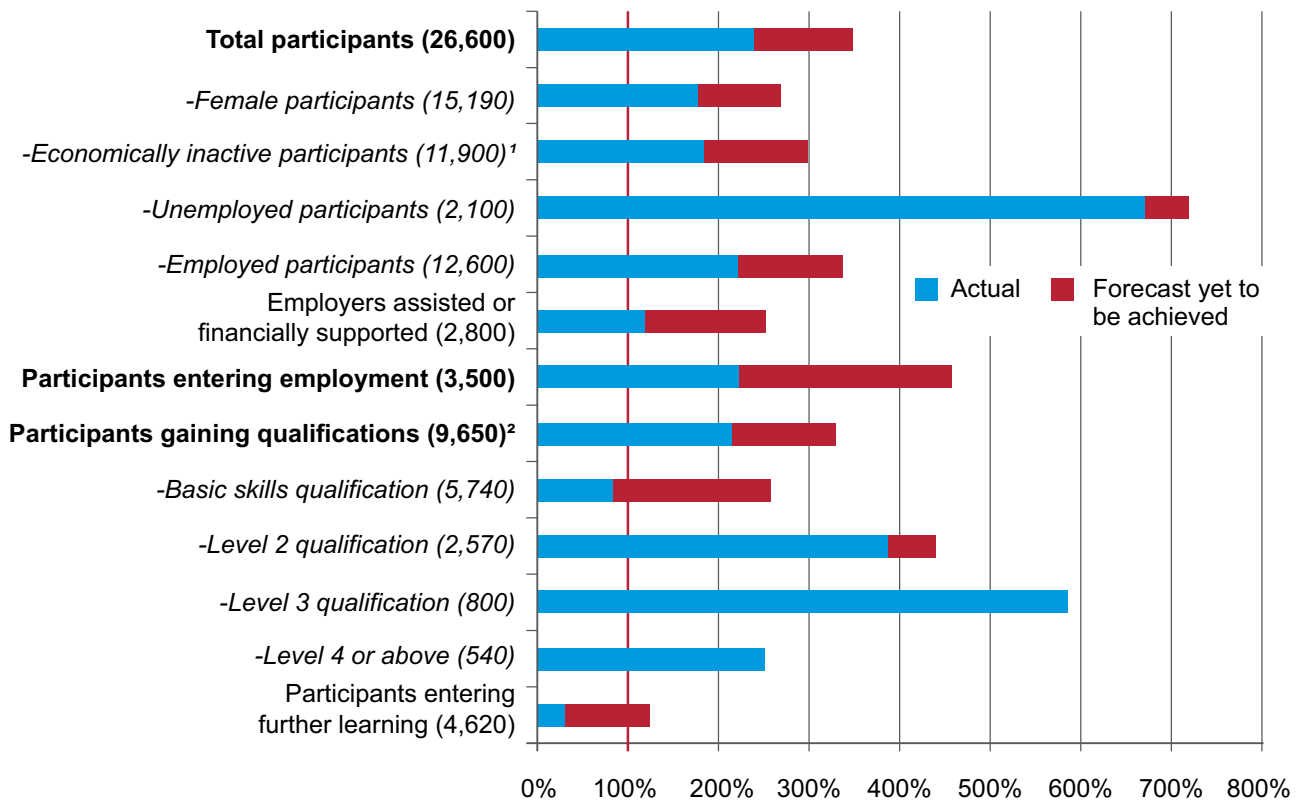
Exhibit 12 – Actual and forecast performance against ESF Programme targets at 31 December 2013

The graph shows forecast performance to the end of the programming period for each indicator as a proportion of target. Blue shows actual performance. Red indicates the balance of the forecast that was yet to be achieved at 31 December 2013. The 100% mark indicates the target, dashboard indicators (**paragraph 2.24**) are shown in bold. The target measure is shown in brackets next to each indicator. Figures are based on project sponsors' returns received by WEFO as at 31 December 2013.

Convergence Programme



Competitiveness Programme



Notes:

1 Economically inactive participants are those who are neither employed for more than 16 hours a week nor unemployed (seeking and available for work or under formal notice of redundancy).

2 Qualification levels relate to the Credit and Qualification Framework for Wales. Broadly speaking, level 2 equates to GCSE, level 3 to A-level and level 4 to higher education qualifications.

Source: WEFO

2.36 Despite the strong performance against the programme level targets, as for the ERDF programmes, the rate of progress against indicators has been slower than projected by project sponsors, possibly reflecting general under-spending and any time lag in the collation of performance information. If this shortfall is not met by the end of the programmes, two of the programme level targets (participants entering further learning for both programmes) would be missed, but all of the other targets would still be met by a substantial margin.

2.37 Looking beneath the programme level targets, there have been a number of areas that are not performing as strongly as expected. For example:

- a Priority 1 of the Convergence Programme, which aims to prevent young people aged 11-19 from dropping out of learning or under-achieving, was a new area of activity for the Structural Funds and was relatively slow to start. Around 108,000 young people had participated in related projects by the end of 2013, well above the 35,500 target for the whole programming period. However, the target assumed that project services would be directed at young people most at risk. In practice, projects have attracted a wider range of participants, with WEFO believing that projects are more effective if a wider group of young people take part. The number of young people gaining qualifications gained is forecast to exceed target, but not to the same extent as the number of participants. The number of participants entering further learning is lagging well behind other indicators, partly because sponsors can only count those who proceed to a higher level of non-compulsory education within six months of completing their participation in the project.

It appears that sponsors had expected a looser definition of this indicator when setting their targets.

- b There is likely to be a shortfall in the number of employers assisted or financially supported by the measures designed to increase employment and reduce economic inactivity. Forecast performance is 58 per cent short of target for the Convergence Programme and four per cent short for the Competitiveness Programme. Economic circumstances have made it difficult for projects to engage employers in measures to help the unemployed and economically inactive, and WEFO does not expect the situation to improve significantly before the end of the programmes. In contrast, the forecast for the number of employers assisted to train their existing workers is well ahead of target.
- c As noted previously, progress on Priority 4 of the ESF Convergence Programme (modernising and improving the quality of public services) has been slow and WEFO has withdrawn some of the funding originally allocated to this priority. Project sponsors' forecasts indicate that this priority will fall 75 per cent short of its target for the number of participants and 82 per cent short of target for the number of secondment placements by the end of the programme, but that targets for collaborative agreements between public service bodies, dissemination initiatives and other indicators of collaborative activity will be exceeded. Activity in this area has had a much stronger emphasis on collaboration than originally intended, with a smaller-than-expected proportion of the available funds devoted to leadership and procurement training.

- 2.38 While there are differences in the nature and size of the programmes and the definition of outputs, the targets agreed with the Commission for the 2007-2013 ESF programmes were generally lower than those set for the 2000-2006 ESF programmes. WEFO wanted the 2007-2013 targets to reflect the better control over double-counting that they expected to apply, and the greater emphasis on hard-to-reach groups. WEFO also wanted the programmes to declare only those outputs that involved substantial intervention by the project sponsor that was capable of having a long-term impact on the beneficiary, and set conservative targets to reflect this intention.
- 2.39 Nevertheless, the degree to which they have been surpassed suggests that the ESF programme targets were set too low. In order to keep a clear challenge in place for the remainder of the programme period, in December 2011, WEFO asked the European Commission to increase targets for 23 of the 27 programme level indicators by between 33 and 461 per cent¹⁹. These changes have not yet been agreed by the European Commission and there is a suggestion that to make this kind of change would cloud the picture of what has been achieved against the original delivery plan. If the targets do change as proposed previously by WEFO, the forecasts as at 31 December 2013 indicate that most of the revised targets would still be met.

The cross-cutting themes of environmental sustainability and equal opportunities are better established than in previous programmes, but the programmes are likely to fall short of most of their related targets

- 2.40 Under EU regulations, the two cross-cutting themes of environmental sustainability and equal opportunities must be integrated into all aspects of the Structural Funds programmes. **Exhibit 13** outlines the objectives under each theme. WEFO monitors the cross-cutting themes using a series of indicators agreed with the European Commission, some of which have general application (general indicators) and others that are specific to certain types of activity (specific indicators). The cross-cutting themes must also be addressed in project and programme evaluations.
- 2.41 A WEFO-commissioned process evaluation²⁰ reported in January 2011 that integration of the cross-cutting themes at the headline level (for example, in project plans) had advanced since the previous programming round. Guidance and support from WEFO specialist advisors was said to be good and most projects scored medium or high against assessment criteria for the two cross-cutting themes. That pattern is also reflected in figures reported more recently by WEFO to the Programme Monitoring Committee.

¹⁹ WEFO has also asked for permission to reduce to some priority level targets to reflect particular difficulties in delivering the planned level of performance (notably in relation to public service reform initiatives) or where it expects to withdraw services to avoid the risk of duplication with services provided by the UK Government's Work Programme. Such duplication would be contrary to EU regulations on additionality.

²⁰ Old Bell 3 Ltd et al, *Effectiveness of Implementation in the 2007-2013 Structural Funds Programming Period*, evaluation commissioned by WEFO, January 2011.

Exhibit 13 – Cross-cutting Structural Funds objectives on environmental sustainability and equal opportunities

Environmental sustainability

- reduce emissions of greenhouse gases to help limit the extent of climate change and to help adapt its effects;
- promote sustainable transport;
- promote the efficient use of resources;
- promote the sustainable management of the land, sea and inland waters; and
- improve the quality of the local built environment and opportunities to access green space.

Equal opportunities

- increase the number of individuals with multiple disadvantages who gain access to employment and self-employment;
- increase the number of women, BME people and disabled people securing training and employment in higher paid and higher skilled sectors and self-employment;
- challenge occupational segregation by increasing the numbers of women and men training or retraining in non-traditional areas, focusing on areas where there are skills shortages; and
- increase the number of employers and training organisations that have equality and diversity strategies, including monitoring systems and methods for building in improvements.

Source: WEFO

2.42 However, the evaluation concluded that project sponsors were making variable progress in integrating the themes into project delivery. Some sponsors still viewed the themes as a compliance exercise and a lack of knowledge and resources meant that sponsors were unable to provide sufficient advice to contractors and project beneficiaries. Some sponsors had deferred specific work on the cross-cutting themes until their projects were well established, which may account for some of the shortfall in performance against the general indicators. Subsequent thematic evaluations²¹ found areas of good practice, where projects had actively targeted under-represented groups and monitored the effectiveness of the measures taken, but other areas where a more passive approach had not delivered the progress expected.

Environmental sustainability

2.43 The ERDF programmes have a general target of ensuring that 20 per cent of enterprises or organisations assisted adopt an action plan to improve environmental performance. At the end of 2013, only 10 per cent of assisted enterprises or organisations had adopted a plan, although the position was expected to improve to 14 per cent by the end of the programmes. The January 2011 process evaluation found that sponsors lacked the capacity to provide the expert support needed to deliver the original target (which was to adopt a formally accredited environmental management system) and the Welsh Government business service centres to which clients were referred were unable to cope with the level of demand. WEFO also believes that the economic downturn has reduced the capacity of the environmental business support sector to deliver services.

²¹ Welsh European Funding Office, *Thematic Evaluations of the 2007-2013 Structural Funds Programmes in Wales: Synthesis Report*, Welsh Government, 2013.

WEFO responded by replacing the original target, with a target to adopt action plans that do not necessarily require professional advice. Nevertheless, there are no plans to increase capacity to provide support.

- 2.44 The programmes have made mixed progress against the specific environmental sustainability indicators. Eight of the 15 indicators are forecast to be met or exceeded by the end of the programming period, some by a large margin. At the end of 2013 project forecasts indicated that the ERDF programmes would:
- a Exceed targets for environmental risk management initiatives, initiatives to develop the natural or historic environment, provision of public access to the countryside or coast, reduction in greenhouse gas emissions and people benefiting from flood protection measures. This reflects the good progress made on environmental management projects, the introduction of home energy efficiency measures and the higher than expected funding devoted to flood protection measures.
 - b Fall well short of targets for renewable energy generated, energy saved, waste reduction and enterprises monitoring carbon emissions. There has been slow progress with most energy and waste projects.
- 2.45 The ESF programmes are likely to miss the three priority-level targets for integrating environmental sustainability into awareness raising, education and training, although there was a marked improvement in performance during 2012 following an exercise by WEFO to provide additional support to projects. The programmes were also likely to exceed the target for 10 per cent of projects to provide specialist training in sustainable development.

Equal opportunities

- 2.46 Evaluations of the 2000-2006 programmes concluded that more needed to be done to support and encourage employers to integrate equality procedures into their operations. The target for 50 per cent of enterprises, organisations and employers assisted to adopt or improve an equal opportunities strategy is a key aim of the 2007-2013 programmes. Performance against the target has been disappointing: forecast achievement is around 21 per cent by the end of the programmes, and actual achievement was 12 per cent at the end of 2013.
- 2.47 Progress on ERDF projects has been hindered by the reprioritisation of funding away from certain support services as a consequence of the Welsh Government's Economic Renewal Programme. For ESF projects, WEFO attributes the under-performance to a combination of under-reporting by project sponsors and the impact of delays in delivery and staff turnover in sponsors' project development teams. In some cases, project staff have been unaware of the commitment to deliver on the equality indicator. WEFO has been meeting sponsors and issuing good practice case studies to raise awareness of the cross-cutting themes and to show how they can be integrated into project delivery. WEFO expects achievement rates to rise as these issues are addressed, and expects project evaluations to uncover other evidence of equality-related benefits. However, a major improvement is unlikely without additional resources to support companies and employers.
- 2.48 WEFO produces extensive data on the proportion of ESF participants in 'key intervention groups' which include gender, age, ethnicity and disability. Output targets are set for the percentage of participants from each group, but not for results (for example, participants gaining qualifications or entering employment). The following patterns are evident from the data at 31 December 2013:

- a *Gender*: around 45 per cent of ESF programme participants were female, compared with an average target of 55 per cent across the two ESF programmes. There was a similar pattern for participants gaining qualifications (43 per cent female) but only 36 per cent of participants entering employment and 37 per cent of those entering further learning were female. Only around two per cent of female participants in in-work training schemes funded by the ESF Convergence Programme were part-time workers, compared with a target of 29 per cent.
- b *Older participants (aged 50 and over)*: were under-represented across the two ESF programmes. Only eight per cent of participants were from this age group, against a target of 36 per cent, although this was forecast to increase to 21 per cent by the end of the programmes. Older workers accounted for a similarly low proportion of participants gaining qualifications, entering employment or entering further learning.
- c *Black minority ethnic (BME) status*: BME participation rates were generally fairly low, at around four per cent for both ESF programmes, but this reflects the relatively small BME population in the Convergence area. The BME participation rate was much higher for the economic inactivity measures in the Competitiveness Programme – 18 per cent against a target of 12 per cent.
- d *People with a work-limiting illness or a disability*: accounted for about 27 per cent of participants in projects aimed at tackling economic inactivity, compared with an average target of 54 per cent and a forecast for the end of the programmes of 39 per cent. These people were less likely than other participants to gain qualifications but more likely than other groups to enter employment. The group was particularly poorly represented on employer training schemes, at around three per cent against a target of 13 per cent.

2.49 Overall the figures indicate that the ESF programmes will not have the expected impact on the 'key intervention groups' compared with other groups. To some extent this reflects the impact of the economic downturn, which has increased the number of unemployed participants relative to those classified economically inactive. A higher proportion of the unemployed are young and/or male. However, the thematic evaluations²² indicated that project design was also an issue. For projects aimed at increasing employment, there were gaps in the provision of services specifically for older workers, those with caring responsibilities and those facing transport barriers in obtaining employment (these last two being more likely to be women). For projects aimed at raising skills, the evaluation found that projects had been 'fairly passive' in their approach to engaging with targets groups, reflected in the very low proportion of disabled and older participants to date, groups for which no dedicated projects had been commissioned.

²² Welsh European Funding Office, *Thematic Evaluations of the 2007-2013 Structural Funds Programmes in Wales: Synthesis Report*, Welsh Government, 2013.

2.50 Because the ESF programmes are likely to exceed their participation targets by substantial margins, the overall number of women and BME participants is still likely to be higher than originally expected. But the number of older participants and those with a work-related illness or disability is still likely to fall well short of expected levels (by around 54 per cent and 23 per cent respectively, based on the position at 31 December 2013).

Remedial action planned by WEFO

- 2.51 WEFO officials recognise that progress against the equal opportunities and environmental sustainability targets has been patchy and told us that they planned or were undertaking the following remedial measures:
- a meeting sponsors to discuss recovery plans where performance has been patchy;
 - b sharing examples of good practice and encouraging projects that are struggling to learn from others undertaking similar activity;
 - c holding discussions with several organisations about developing a specific project to support delivery of the specific indicators;
 - d for the 2014-2020 programmes, integrating the equal opportunities and environmental sustainability targets more closely with day-to-day project activity, so that they are not seen as an add-on requiring separate strands of activity; and
 - e organising a rolling programme of training events to support the new approach for the 2014-2020 programmes (the first series of events has already been held for WEFO staff and those delivering projects).

While it is too early to fully assess the overall impact of the programmes, there are some positive signs and ongoing evaluations will paint a clearer picture

There is limited evidence available at this stage about the long-term impact of the 2007-2013 programmes, although evaluation work is ongoing

2.52 The direct impact of socio-economic programmes is hard to assess with any precision because it can be affected by other factors in the external environment, such as the recent economic downturn²³. Moreover, the impact of these programmes can include 'soft' outcomes such as greater personal confidence or better relationships and joint-working between people and organisations.

2.53 Performance against the impact indicators in the operational programmes is assessed as part of programme evaluation. Much of this evaluation work is planned to take place towards the end of the programming period and, as at the end of 2013, the amount of published evidence on impact was fairly limited. However, some evidence of impact is available from the following sources, mainly covering the ESF programmes:

- a *The ESF Leavers' Survey* (a major annual survey of participants leaving ESF provision) and the *ERDF Business Survey* (of firms receiving ERDF support). WEFO uses the findings from these large-scale surveys to estimate the net impact of the ESF programmes on employment outcomes and the net impact of the ERDF programmes on job creation.

²³ One approach that can be taken is to try to calculate the net impact after factors such as 'deadweight' and 'displacement' are taken into account. Deadweight is the amount of reported benefits that would have happened anyway without the assistance of the programme. Displacement is the extent to which benefits are simply transferred from one place to another because of an intervention. This calculation may involve comparison with control groups (a representative sample of beneficiaries who have not participated in the programme), or the use of standardised discount factors to estimate deadweight, displacement and multiplier effects. The multiplier effect is the extra economic activity that is generated indirectly by the assistance, usually through spending on local suppliers.

- b *Interim thematic evaluations.* WEFO commissioned a series of interim thematic evaluations that cover individual programme priorities and published these findings in December 2013. The evaluations focus on policy issues, operational arrangements, the likely effectiveness of services and performance against monitoring indicators rather than impact. However, the two evaluations published by the end of May 2013²⁴ do draw some inferences on impact from survey evidence and interviews with participants. The interim thematic evaluations will be followed by final evaluations that will consider the programmes' impact in more depth.
- c *Interim project evaluations commissioned by project sponsors.* As at 31 May 2013, WEFO had published 10 project evaluations on its website with around 40 others due to be published later in the year. Most of the 10 evaluations published at that time included some assessment of impact, based mainly on analysis of monitoring data and the results of participant surveys or interviews. Eight of the evaluations were for ESF projects and two were for ERDF projects, with these projects ranging in value from £2 million to £78 million.

- a There was generally good coverage of programme objectives and expected activities across all thematic areas of the programmes. The main gap was in strategic infrastructure, where there was a much greater focus on road schemes rather than the expected balance between public transport and road.
- b There was a high level of satisfaction with the services provided from ESF participants and employers, especially with the quality of provision. Where relevant, participants particularly valued the provision of individually tailored support from mentors and counsellors.
- c Project administration was generally effective, notwithstanding some initial teething problems and delays. Project management capability varied between and within projects.
- d Projects had adapted fairly well to collaborative working²⁵ and there were many examples in all areas of the programmes, although it had taken some time to establish effective joint working arrangements where the scale of joint working was a new development, for example in regional projects aimed at supplying young people with the skills needed for future employment. Several project evaluations reported concerns that partners were not referring participants to the project as much as they should or commented on the need for greater sharing of good practice between project delivery staff.

2.54 In addition to their findings on impact, there are some common themes arising from most of the evaluations. For example, the evaluations found that:

²⁴ These two evaluations related to Priority 1 of the ESF Convergence Programme (supplying young people with the skills needed for learning and future employment) and Priority 2 of the same programme (increasing employment and tackling economic inactivity).

²⁵ Collaborative working between partners and projects is a key aim of the current programming round (paragraph 3.1).

Evidence available for the ESF programmes indicates a positive effect on participants, but the impact on employment rates varies significantly by gender, location and employment history

Supplying young people with the skills for future employment

- 2.55 Evaluations in this area were based on in-depth interviews with stakeholders (project staff and others involved in providing or overseeing services) and participants. The evaluations received very positive feedback on the services provided and participants reported beneficial effects on their confidence, social skills, motivation and aspirations. There was a strong feeling among stakeholders that the services added value to existing provision and had a positive impact, a conclusion endorsed by the evaluators themselves. However, due to gaps in data and inconsistent application of the measurement tools available, it was not possible to quantify the 'soft outcomes' achieved, the achievements that indicate progress – 'distance travelled' – on the path to employment.
- 2.56 None of the evaluations were able to quantify the scale of impact on longer-term outcomes. However, the Engage project evaluation sought to calculate the project's effect on some indicators of social exclusion (Exhibit 14).

Exhibit 14 – Impact assessment for the Engage project

Engage was a collaborative project between 10 local authorities and further education colleges to help young people aged 14-19 in South-West Wales to improve school attendance and build confidence to maximise career opportunities. Activities included counselling, mentoring, work placements and voluntary work. The project cost £21 million and ran for around three years to the end of 2012.

The evaluation of the Engage project compared trends in the proportion of year 11 school leavers not in employment, education or training (NEET), the proportion of pupils leaving school without qualifications, unauthorised absenteeism from school and school exclusion rates between areas covered by Engage and those not covered by the project. It found that positive trends were significantly higher in Engage areas compared with the rest of Wales and suggested that up to half of the improvement could be attributed to Engage. The evaluation acknowledged that such analysis was 'flawed in many respects' because it was difficult to adjust for the effect of other factors, but concluded that the analysis nevertheless 'gave an insight into the scale of achievement within a relatively short period of time.' However, it was not possible to attribute longer-term outcomes such as employment to the project, given the relatively short period of time during which it had operated.

Source: Wavehill Ltd for Neath Port Talbot Council, 'Engage Project – Final Evaluation', January 2013

Increasing employment and tackling economic inactivity (improving participation)

2.57 The most developed evidence of impact is from the annual ESF Leavers' Surveys. The most recent published survey findings²⁶ asked 3,544 participants who left ESF programme services in 2011 about the reasons for their participation, its benefits and what had happened to them since. The survey report included an assessment of net impact by comparing career transitions for survey respondents, such as getting a job, with those for a matched sample of non-participants drawn from the Annual Population Survey.²⁷ Key findings from the Leavers' Survey include:

- a Most participants gained qualifications, and higher qualifications were associated with greater benefits. Around 73 per cent of respondents obtained a qualification and, where able to be established²⁸, 13 per cent of respondents reported that the qualification they obtained was at a higher level than their previous qualification(s). Those obtaining a same or higher-level qualification were more likely to report a range of positive impacts from their training than other participants.
- b Participants reported a large increase in employment rates following participation: from 14 per cent to 66 per cent. Only 22 per cent of respondents finding work thought that ESF intervention had been 'vital' in helping them secure their job²⁹. However, across different client groups, employment rates were higher than the comparable control groups. Employment outcomes varied by participants' employment history and other personal circumstances:

- Employment outcomes were significantly better for the recently unemployed who received training specifically for those made redundant – 76 per cent were in employment 12 months after completion of their training, 12 percentage points higher than the control group. In contrast, employment rates were 43 per cent for other unemployed participants (six percentage points higher than the control group) and only 17 per cent for economically inactive participants (nine percentage points higher than the control group).
- Employment rates were significantly poorer for those with a work-limiting health condition or disability, for those aged under 25 or over 55, and for those who had been out of work for more than a year.
- Local employment conditions had an effect, with poorer outcomes for participants living in areas with the lowest employment rates (ie, much of the South Wales Valleys).
- Around 85 per cent of participants who had found paid work were satisfied with their jobs. However, earnings and skills levels tended to fall below the Welsh average, especially for the Convergence Programme. Participants who had received redundancy training were nine to 13 percentage points less likely to enter low-paid employment than a control group, but there was no statistically significant effect for other groups.

²⁶ Cardiff University, Old Bell 3 Ltd and IFF Research Ltd, *The 2011 European Social Fund Leavers' Survey*, WEFO, March 2013.

²⁷ The matched sample of non-participants (those not participating in ESF) was selected to replicate as closely as possible the characteristics of the respondents to the Leavers' Survey, thereby enabling reliable comparisons to be made between the two groups. The Annual Population Survey asks around 16,000 households in Wales every three months about their own circumstances and experiences regarding a range of subjects including housing, employment and education.

²⁸ Excluding the 51 per cent of the population for whom qualification levels before and after intervention could not be established.

²⁹ Similarly high levels of deadweight were reported by participants in the ReAct programme, which provided financial support for re-training to people who had recently lost their jobs through redundancy.

2.58 Project evaluations for careers guidance and graduate placement services reported high levels of satisfaction with the guidance and other services provided, and a perception among participants that the projects had helped them secure employment where this occurred. Employers that provided graduate placements reported commercial benefits from the placements and that they were more likely to recruit graduates in the future.

Increasing skills and adaptability of employees in the workplace (supporting progression)

2.59 The ESF Leavers' Survey 2011 found that 73 per cent of participants gained a qualification, but only 17 per cent of those whose qualification transition could be determined gained a higher-level qualification than the highest level they had previously achieved. There was a marginal improvement in the proportion of participants holding qualifications at levels 3 and 4 of the National Qualifications Framework (A-level standard and above). However, a high proportion of participants said they had generic skills (eg, communications, organisation, team building, leadership) and had gained softer benefits such as confidence or motivation.

2.60 For those already in employment, 65 per cent of respondents to the survey reported having more training opportunities, 64 per cent were more satisfied with their work and 56 per cent reported improvement in future pay and promotion prospects, while 27 per cent said they had had a promotion. These benefits were particularly pronounced where participants had changed jobs, and 20 per cent of these participants said that ESF intervention had been vital in helping them

get their job. Generally, however, only seven per cent of participants said that any improvements in their employment had been directly related to ESF intervention.

2.61 Average earnings of respondents (£391 a week) were higher than for previously unemployed or economically inactive participants and they tended to have longer hours and better security of employment.

2.62 There is relatively little information available on the impacts on employers and the wider economy of ESF training provision. The focus of the monitoring indicators approved by the European Commission is very much on the benefits for individuals. An interesting exception is the evaluation of the ProAct project ([Exhibit 15](#)).

Exhibit 15 – Impact on employers of the ProAct project

ProAct was a £66.8 million project sponsored by the Welsh Government to provide work-related training to employees at risk of redundancy or short-time working during the recession. It ran between January 2009 and June 2010 to address the severe impact of the recession on many major employers in Wales.

The evaluation of the ProAct project quantified the economic benefits in gross value added (wages and operating profit) at £95.8 million for a cost of £21 million, safeguarding 1,833 jobs at a cost per job of £12,015. The evaluation considered this to be a creditable outcome given the exceptionally difficult circumstances that the project was dealing with. ProAct enabled companies to up-skill their workforce in readiness for the upturn and to avoid the loss of skilled and experienced employees. Employers reported an increase in productivity in two-thirds of cases, indicating benefits that went beyond the immediate safeguarding of jobs.

Source: Cambridge Policy Consultants for the Welsh Government, 'Impact Evaluation of ProAct', October 2011

The 2011 ERDF Business Survey results suggest that the ERDF programmes have created or safeguarded a significant number of jobs, but only a minority of respondents credit ERDF with tangible outcomes for their business

2.63 The 2011 ERDF Business Survey reported results from 778 businesses that had received support from the research and development and business support priorities of the two ERDF programmes (a response rate of 40 per cent). The survey did not cover business finance, regeneration, infrastructure or other capital projects, was not able to compare the results with a sample of comparable non-assisted businesses and did not adjust for potential double-counting. While the results, therefore, need treating with caution, the survey found that:

- a Around half of the firms receiving support with forming collaborative research and development partnerships had gone on to consolidate these, with most reporting that these partnerships were important to their business strategy.
- b Respondents were 'surprisingly likely' given the economic climate, to report positive changes in their business. Around two-thirds said they had introduced new or modified products or processes and many others reported financial benefits ([Exhibit 16](#)). However, the extent to which respondents attributed these changes to ERDF was more limited, particularly when asked whether such changes would have occurred in the absence of ERDF.

- c Most businesses were focused on Welsh markets and recruited within Wales, which indicates that assisted companies might displace growth from non-assisted businesses within the programme area. However, this finding was less true of job-creating businesses, and the 38 per cent of respondents who said that ERDF had helped them win new business did not generally associate this with having taken market share from local competitors. The evaluation concluded that the effect of displacement was relatively modest.
- d Only 17 per cent of respondents attributed any job creation to ERDF assistance. Taking into account deadweight, displacement and multiplier factors, the survey estimated that between 275 (75 per cent) and 335 (92 per cent) of the 363 new jobs reported by these respondents could be attributed to the ERDF programmes. This estimate of the proportion of new jobs attributable to the programmes compares favourably with the 29 to 45 per cent ratio estimated for the 2000-2006 programmes.³⁰ Applying the Business Survey ratios to forecast job creation at the end of 2013 would indicate that the 2007-2013 ERDF programmes would create between 32,300 and 39,600 new jobs. However, this estimate needs to be treated with caution due to the limitations of the sample as noted above.

³⁰ Old Bell 3 – *Mid-term Evaluation Update for the Objective 1 Programme*, final report, December 2005. Net impact was calculated by discounting the gross results data forecast by WEFO for the end of the programme, using survey evidence and economic benchmarks. WEFO updated the calculations by substituting the final, actually achieved results for the forecast data.

- e The effect of ERDF in safeguarding jobs is at least as significant as job creation, with around 1.25 jobs safeguarded for every job created. The Business Survey calculated that between 350 and 428 net jobs had been safeguarded. WEFO does not collect monitoring information on jobs safeguarded, but they are clearly an important employment outcome of the programmes. Safeguarding jobs was not considered an objective at the beginning of the programme round when economic conditions were more buoyant, so WEFO has not collected data directly on jobs safeguarded over the whole programme period. They do now ask project sponsors to capture this data informally, and the Commission has indicated that it will be interested in this information when the overall impact of the programmes is assessed after the programme period ends.
- f It was not possible to conclude definitively on the pay and skill levels of jobs created relative to the Welsh average, but the evidence suggested that the qualifications required for all jobs within the respondents' businesses was similar to that for Wales as a whole.

Exhibit 16 – ERDF Business Survey respondents – turnover, profitability, productivity and exports since receiving ERDF support

	Turnover	Profitability	Productivity	Exports
Change reported:				
Increase	42%	34%	42%	34%
No change	49%	60%	54%	62%
Decrease	9%	6%	4%	4%
Perceived impact of ERDF support:				
% of respondents saying ERDF had a positive effect	41%	37%	40%	24%
% of respondents saying outcome would have been worse without ERDF ¹	32%	29%	29%	18%

Note:

¹ % of respondents saying that outcome was 'very likely' or 'likely' to have been worse.

Source: ERDF Business Survey, Old Bell Ltd in association with Cardiff University and IFF Research Ltd, published by WEFO in 2012.

Evidence for the 2000-2006 programmes suggests a positive impact on jobs and skills, but the prosperity gap between Wales and the EU average remains significant

- 2.64 The ultimate aim of the Convergence Programmes is to help close the prosperity gap between the EU average and those regions lagging behind. GDP is usually used as the headline indicator of an area's prosperity and is used by the European Commission to determine which areas receive programme funding, although the programmes are intended to address a wide range of social and environmental objectives that do not necessarily translate into higher GDP.
- 2.65 It is too early to assess the impact of the current programmes on GDP per capita – impacts are likely to occur over the long term and will be difficult to disaggregate from wider economic forces, given that the funding available is a small fraction of the area's economy. Data on regional GDP is also slow to materialise and the latest data is for 2010, when the current programmes had just started to deliver services.
- 2.66 The previous programmes were broadly similar in scale and funded similar activities to the current programmes, albeit in a more favourable economic climate. An analysis by the Welsh Government in 2011³¹ reported that GDP had fallen slightly against the EU-15 average³², and this negative trend accelerated in the subsequent recession as the whole UK economy declined at a faster rate than the rest of the EU. As a result, the GDP of the Convergence area fell from 75 per cent of the UK average in 2000 to 70 per cent by 2010, after peaking at 78 per cent in 2005.

The Welsh Government believes that some of the reduction is due to an out commuting effect – more people working outside the programme area in Cardiff and Newport, so that their production is counted in East Wales rather than West Wales and the Valleys.

- 2.67 Other key indicators showed more favourable results for the decade to 2010. There was a significant increase in primary income relative to the UK and EU averages; primary income measures the income earned from economic activity by residents of an area rather than what is produced in the area, and offsets the out-commuting effect. Employment and economic activity rates have also increased relative to the UK average, as did qualification rates, although they remain below the UK average. The contribution of the Structural Funds to these changes is hard to establish with any certainty. However, an analysis by WEFO in 2011³³, which drew on findings from a mid-term evaluation of the previous programmes in 2005³⁴ and the results reported by projects at the end of the programming period estimated that the programmes had:
- a created between 26,000 and 45,500 net jobs (29 to 45 per cent of the gross figures reported by projects);
 - b created between 1,700 and 2,500 net new SMEs (10 to 15 per cent of the gross figures reported by projects); and
 - c led to between 48,700 and 89,300 ESF programme net participants entering employment or further learning (44 to 80 per cent of the gross figures reported by projects).

31 Welsh Government, *2000-2006 Structural Funds Synthesis Report*, March 2012 and Welsh Government Statistical Directorate (2011): 'Sub-Regional GDP Estimates, paper for the Programme Monitoring Committee,' WEFO, March 2011.

32 WEFO considers the EU-15 (members of the EU in 1999 when Wales qualified for Objective 1 funding) to be the most appropriate comparator for Wales. The economies of the 14 member states that joined from 2004 tend to be growing faster from a lower base, and their inclusion in comparisons would give a less accurate impression of economic performance in Wales.

33 Welsh Government, *2000-2006 Structural Funds Synthesis Report*, March 2012.

34 Old Bell 3 Ltd, *Mid-Term Evaluation Update for the Objective 1 Programme*, WEFO, 2005.

Part 3

Management arrangements are effective and have improved since the previous programming round, despite some disruption in the early stages of Programme implementation

3.1 This part of the report considers WEFO's management of the 2007-2013 programmes with particular reference to:

- a the adaptability of the programmes to changes in policy and external conditions;
- b greater emphasis on a procurement-based approach to delivery;
- c project appraisal procedures;
- d financial management and control; and
- e project delivery, monitoring and evaluation.

3.2 Our analysis draws, in part, on findings from our survey of project sponsors and WEFO project development officers in 2011³⁵ (Appendix 1). It also reflects findings from a WEFO commissioned customer survey in 2009 and a 'process evaluation' exercise completed in 2011. WEFO's procedures have remained largely unaltered since this evidence was collected and most completed or live projects to date were approved before 2011. Nevertheless, it is possible that opinions have shifted since these surveys were conducted.

There have been mixed views about the overall administration of the programmes although stakeholders generally support the action that WEFO has taken to simplify programme structures and reduce the number of projects

3.3 Our survey of project sponsors and WEFO project development officers included some general questions about the overall design and administration of the Structural Funds programmes. Overall the feedback we received suggested that:

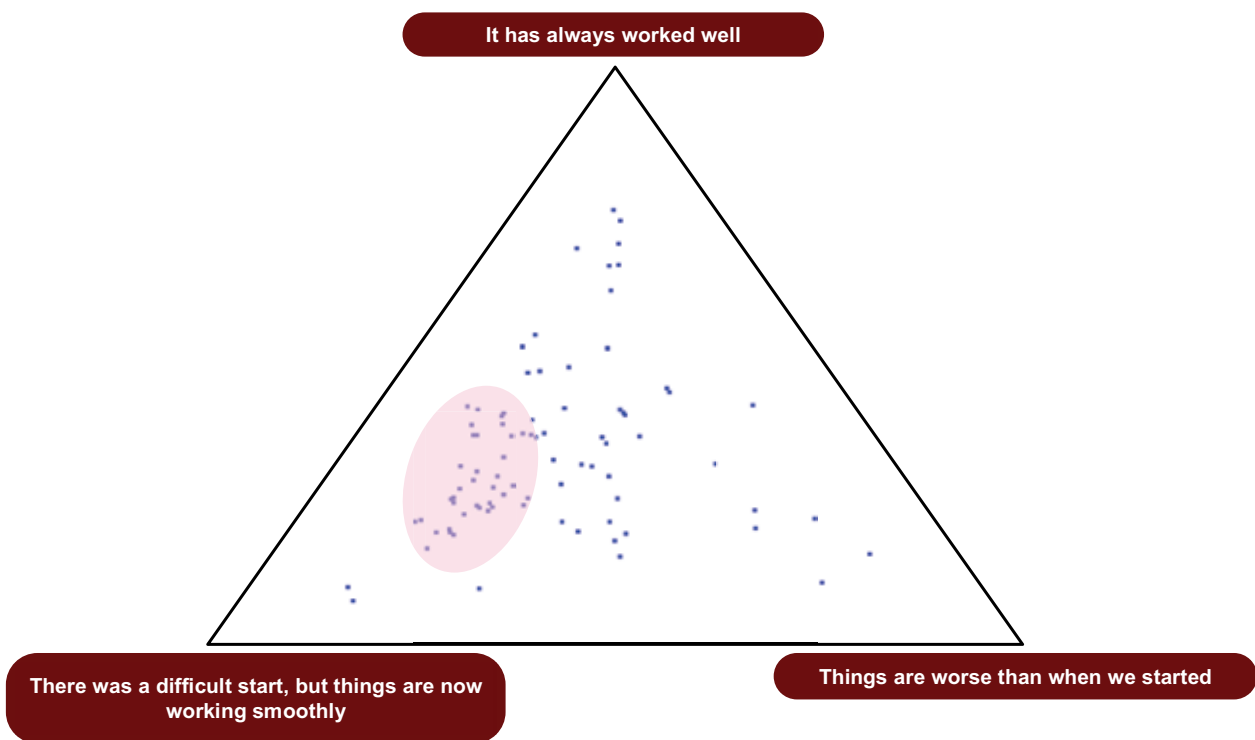
- a the system as a whole was working better after a difficult start (Exhibit 17), but views about its overall efficiency were mixed with project development officers tending to see the system as efficient, whereas project sponsors were fairly evenly divided;
- b decision making by WEFO was seen as slow, but sponsors mainly attributed this to bureaucracy while project development officers tended to attribute it to the complexity of the issues involved;
- c project sponsors tended to view WEFO as being quite rigid in its management procedures and approach to rules and regulations, and to be risk-averse – whereas project development officers were more likely to see WEFO's approach as adaptable and flexible with risks identified and managed;

³⁵ Project development officers are primarily responsible for appraising grant applications and subsequent monitoring of those projects' progress.

Exhibit 17 – Views of Wales Audit Office survey respondents on the management and control system

The survey in 2011 asked respondents to choose a position between the three statements below. The dots show the number of responses and the shaded area indicates the greatest concentration of responses. The results indicate the balance of opinion among responses and are not intended to be analysed quantitatively.

Thinking of the whole system put in place to manage the programmes:



Source: Wales Audit Office survey of project sponsors and project development officers

- d where things went well, both sponsors and project development officers attributed this to the people involved rather than the process followed or the resources available; and
- e where problems occurred, this was attributed to processes more than people or resources.

3.4 We asked our survey respondents to provide a narrative commentary about their experience of the Structural Funds programmes. Overall, 49 per cent of our 91 respondents described their comments as negative and 32 per cent described their comments as positive (17 per cent were neutral and two per cent were unsure). There was no discernable difference between project sponsors and the project development officers.

- 3.5 WEFO's 2009 customer satisfaction survey³⁶ found that 41 per cent of sponsors were satisfied or very satisfied with the overall level of service from WEFO. However, of those who had experience of the previous programming round, 75 per cent said they found the current programmes to be more bureaucratic.
- 3.6 WEFO has sought to streamline administration and reduce costs by simplifying certain programme structures. The main changes, which have had the broad agreement of stakeholders, are:
- a There is now only one Programme Monitoring Committee covering all programmes, rather than the six separate committees that existed for the 2000-2006 programmes.
 - b The 'thematic advisory groups' that previously advised WEFO officials on project selection have been abolished. WEFO now makes funding decisions in the light of appropriate expert advice.
 - c The Operational Programmes are less prescriptive about the allocation of resources than the 2000-2006 programmes. Programme priorities are divided into fewer sub-divisions (known as 'measures' in the 2000-2006 programmes and 'themes' in the current programmes). Previously, the European Commission exercised control over any changes to measure budgets. For 2007-2013, WEFO has flexibility in transferring funds between themes because the funding allocations are indicative only.
- 3.7 WEFO funded 2,463 projects in the comparable programmes³⁷ under the previous programming round. The administration of so many, relatively small, projects was very resource intensive. WEFO resources were focused on certain core tasks relating to project appraisal, payment of grants and compliance issues rather than more active performance management of individual projects. WEFO has succeeded in reducing the number of projects dramatically in the current programming round, with a much greater proportion of programme expenditure being through higher value projects (**Exhibit 18**). There were 287 projects at 31 December 2013, of which 107 were sponsored by the Welsh Government. WEFO expects the overall number of projects to increase a little by the end of the programmes, with some smaller projects being approved to address particular needs and to use available resources.
- 3.8 Our survey findings, and our wider fieldwork, indicated general in-principle support for the shift towards fewer, larger projects, although the survey findings pointed to some concerns about the practical application of this approach and collaboration and partnership working in general. Comments made by some survey respondents raised a variety of practical concerns about the delivery record of some larger projects, the difficulty of involving the voluntary sector, and the need for WEFO to be more active in encouraging and supporting collaboration.

³⁶ Databuild Research and Solutions, *WEFO Customer Insight Survey 2009*, WEFO, May 2010.

³⁷ Objective 1, Objective 2 and Objective 3 programmes in the 2000-2006 programming round

The programmes have been flexible enough to respond effectively to the economic downturn and to some significant changes in policy

WEFO re-allocated resources to respond to the economic downturn and used the opportunity of a weaker pound to reduce pressures on match funding

3.9 WEFO took several important measures to ensure that the programmes were best placed to help Wales respond to the challenges of the economic downturn that began in 2008. This action was endorsed by the European Commission and included:

- a The Welsh Government developed and implemented the ProAct project to help employers train their staff during period of down-time and expanded the ReAct project, which provided discretionary grants to unemployed individuals to help them re-train following redundancy. Skills Growth Wales, introduced in April 2010 as the successor to ProAct, has a stronger emphasis on company growth and higher skills to promote economic recovery. ReAct was re-launched in April 2011 to focus more on recruitment of new staff rather than re-training of redundant workers.
- b Re-allocating resources and changing eligible activities to meet specific needs, including:

Exhibit 18 – Change in average size of projects by value of approved EU grant for comparable programmes

	2007-2013	2000-2006
Total number of projects	287	2,463
Average value of project (approved grant, £000)	£6,654	£584
Proportion of programmes delivered by projects with approved EU grant of:		
Below £100,000	0.04%	2.9%
£100,000 – £999,999	1.3%	31.2%
£1 million to £9.999 million	41.9%	57.3%
£10 million or over	56.7%	8.6%

Source: WEFO (approved project databases as at 31 December 2013)

- transferring £37.7 million from ESF Convergence Priority 1 (preventative work with young people) into Priority 2 (increasing employment and tackling economic inactivity) to help tackle the rise in unemployment;
 - making careers advice and guidance an eligible activity to meet high demand for in-depth personal careers guidance; and
 - providing some funding to encourage sustainable tourism initiatives to take advantage of opportunities to increase market share while addressing problems created by the downturn.
- c Negotiating with the European Commission an increased intervention rate for EU funding to reduce pressures on match funding resulting from the economic downturn generally and from the weakening euro/sterling exchange rate. The weakening value of the pound meant that more EU funding, which is paid in euros, was potentially available to Wales. But this, in turn, would have required additional match funding without an increase in the EU funding intervention rate.

WEFO worked quickly and effectively with other parts of the Welsh Government to reflect policy changes arising from the launch of the Economic Renewal Programme in 2010

3.10 In July 2010, the then Minister for the Economy and Transport launched *Economic Renewal: a new direction*. The underpinning 'Economic Renewal Programme' is designed to support sustainable recovery from the economic downturn and centres on five priorities:

- a investing in high-quality and sustainable infrastructure;
 - b making Wales a more attractive place to do business;
 - c broadening and deepening the skills base;
 - d encouraging innovation; and
 - e targeting Welsh Government business support on six sectors where Wales can gain competitive advantage (ICT, energy and environment, advanced materials and manufacturing, creative industries, life sciences and financial and professional services).
- 3.11 Following the Minister's announcement, WEFO initiated a review of the two ERDF programmes. Alongside this, the Welsh Government undertook a review of projects it sponsored under the ERDF programmes to ensure they too were aligned with the Economic Renewal Programme. The reviews were completed by September 2010 and, with European Commission approval, led to the following changes to the ERDF Convergence Programme and consequent changes to relevant programme targets:
- a support for business was focused on the six priority sectors identified in the Economic Renewal Programme;
 - b funds originally earmarked for direct support to business (£40 million of EU funding and £50 million in match funding) were re-allocated to transport infrastructure projects, reflecting a change in emphasis from grants to investment and infrastructure; and
 - c funding originally earmarked for technical assistance (£10 million of EU funding and £11 million in match funding), was reallocated to regeneration projects.

- 3.12 There were also two changes to the ERDF Competitiveness Programme:
- a ICT and R&D infrastructure activity (the latter was previously only funded by the Convergence Programme) became eligible for support and, where necessary, relevant indicators were developed to reflect this; and
 - b two programme targets, 'enterprises assisted' and 'new or improved products, processes or services launched' were reduced to reflect the scaling back of specific projects.
- 3.13 Some projects were re-designed and others were terminated or scaled back. Overall, WEFO withdrew £50 million from approved projects, with the objective of reallocating this funding to projects that better supported the aims of the Economic Renewal Programme. The predominance within the current programmes of large scale projects, many of which are managed by the Welsh Government, made the process of redesigning projects and/or withdrawing funds from projects easier than might have been the case under the previous programmes.

WEFO has modified the ESF programmes to avoid duplicating the UK Government's 'Work Programme'

- 3.14 The UK Government introduced the 'Work Programme' in July 2011. The Work Programme largely replaces all pre-existing UK Government welfare-to-work schemes and is part funded by ESF.³⁸ The Work Programme provides tailored support to help people who are long-term unemployed or economically inactive obtain employment. It covers Jobseekers' Allowance and Employment and Support Allowance recipients once they have received benefits for a specified period, ranging from three to 12 months depending on individual circumstances.
- 3.15 The Work Programme targets the same people as many projects across the two ESF programmes in Wales. To avoid duplication and ensure compliance with requirements to demonstrate added value, WEFO decided that it would re-focus most of its ESF programme activity on those who are not eligible for the Work Programme, such as lone parents with young children, 16-17 year olds and Incapacity Benefit claimants, as well as those who, while eligible to join the Work Programme, have not yet done so. WEFO had proposed excluding all those eligible to join the Work Programme, but amended its plans to reflect concerns that the Work Programme would not be able to support all eligible clients and some individuals might not be eligible for support from any programme.
- 3.16 In any case, the Work Programme was considered likely to reduce demand for measures designed to increase employment. WEFO therefore proposed re allocating £26 million of EU funding to measures designed to prevent economic inactivity among young people and workforce skills development, for both of which there has been buoyant demand. These changes were approved by the Programme Monitoring Committee in December 2011 and are currently waiting for approval from the European Commission.

³⁸ In January 2012, the National Audit Office reported on *The introduction of the Work Programme*. The Work Programme itself is part-funded by ESF paid to the Department of Work and Pensions.

The greater use of competitive procurement as a delivery model has proved difficult to implement, but if well managed should have positive effects in the longer term

WEFO has placed a greater emphasis on competitive procurement and expects that around a third of all programme expenditure will be spent through procurement by project sponsors

3.17 For the 2000-2006 programmes, competitive procurement³⁹ was used by project sponsors for some business support and training projects but was not the most common delivery model. For the 2007-2013 programmes, WEFO has required sponsors to procure service delivery unless there is a special relationship between the sponsor or the grant recipient and the target group of beneficiaries, and then only if there is not a genuine market for the services involved.

3.18 Many projects operate mixed delivery models, with some services being procured and others delivered directly or via grant schemes. Overall, WEFO expects at least £1.30 billion or 35 per cent of total programme expenditure to be spent on contracts procured by sponsors. At 31 December 2013, project sponsors had awarded a total of 2,569 contracts worth £1.09 billion through procurement, mostly to the private sector. The amount subject to procurement is likely to be significantly higher due to under-reporting by sponsors.

3.19 The greater emphasis on competitive procurement is intended to deliver the following benefits:

- a A lower risk of non-compliance with regulations, especially:
 - *European Union public procurement regulations*: These regulations require contracts let by public authorities to be let by open competition according to specified procedures.
 - *State Aid*⁴⁰ rules: To avoid distorting competition between member states, State Aid is illegal unless it has been specifically approved or falls within certain exempt categories. By testing the market and paying the market price through competitive procurement, WEFO minimises the risk that any contractor will be deemed to have received illegal State Aid.
 - *European Commission rules governing the eligibility and accuracy of expenditure*: Once a service has been procured, the contractor's own expenditure does not normally need to be audited. In contrast, project expenditure by grant recipients is fully covered by the rules⁴¹.
- b Improved and demonstrable value for money, because services are provided after testing the market for the most appropriate suppliers.
- c Wider access to the opportunities provided by EU funding to the private sector and, potentially, to the voluntary sector (although the voluntary sector benefited previously from grant funding and is less familiar with competitive procurement as a source of funding).

³⁹ A competitive procurement exercise tests the market for suppliers of clearly specified services, tenders are evaluated using pre-defined criteria, and contractors are free to make a profit. Competitive grant schemes award grants to a smaller range of organisations, usually with extensive flexibility as to the form of provision, and rules and procedures are often simpler than for procurement. Grant awards are evaluated against pre-defined criteria. However, grant recipients cannot make a profit from the grant.

⁴⁰ State Aid means any subsidy given from state resources (public funds) to any organisation for undertaking a particular economic activity that is traded between member states of the EU.

⁴¹ Grant recipients must keep very detailed records to show that all expenditure is eligible and correctly calculated which often involves the use of timesheets to apportion costs. These requirements are complex, onerous and prone to error. Compliance is audited by a project's external auditor and potentially by WEFO and the Audit Authority too.

The greater emphasis on competitive procurement has been difficult to implement although some of the early challenges have been overcome

- 3.20 When the programmes were launched in 2007, WEFO's policy on procurement was not clear to some sponsors and formal guidance was not published until 2008. Even then, many sponsors complained to WEFO that the guidance was unclear. WEFO's 2009 customer satisfaction survey revealed a lower level of satisfaction for advice on procurement and State Aid issues than for other aspects of project development, and similar concerns emerged from our own fieldwork and from WEFO's process evaluation in 2011. Complaints centred on ambiguous advice and frustration at not being able to access Welsh Government procurement expertise directly.
- 3.21 WEFO did not employ its own procurement specialists for the current programmes and had to seek legal advice on the procurement and State Aid risks on a case-by-case basis. Some project sponsors had to re-design their business

plans to adopt a procurement approach, causing difficulties where joint sponsors may have been expecting to deliver services directly. In addition, many project sponsors faced practical difficulties in adopting suitable procedures for competitive procurement due to a lack of expertise or simply because they under-estimated the work involved, leading to considerable delays (**Exhibit 19**). WEFO has no obligation under European regulations or guidance to provide support for sponsors for procurement or any other management function. Indeed, it is important for WEFO to remain independent of project delivery so as not to compromise its official oversight function. Nevertheless, acting on a recommendation in the Guilford Review, for the next programming round WEFO has decided to enable a degree of arm's length procurement support for those sponsors that, in WEFO's view, might reasonably find the process to involve unsupportable overheads. WEFO's view remains, however, that sponsors in the private and public sectors should have their own procurement capability and not require specialist support.

Exhibit 19 – Problems faced by sponsors when implementing procurement requirements

Project sponsors told us about several examples of practical difficulties they faced in establishing effective procurement practices in their projects:

- Difficulties in recruiting staff with the desired skills and experience and delay in training tender assessors.
- Bidders – mainly small voluntary organisations unfamiliar with procurement as a funding route – found it hard to adjust to procurement requirements, with many failing at the due diligence stage because of technical failings unrelated to the underlying quality of their bid, such as not having a data protection policy.
- Reluctance of voluntary organisations to commit to legally binding contracts, leading to delays in commencing delivery.
- Sponsor used competitive dialogue, a process by which a final bid is developed through several iterations until it meets the buyer's objectives. However, the technique is more often used for large capital projects and proved impractical and time consuming, leading the sponsor to switch to a more conventional approach.
- Sponsor did not run a pre-qualification exercise (standard practice for large procurement exercises to restrict the number of full tenders) and had to assess over 200 full tenders. The sponsor subsequently hired procurement consultants to develop a process that included a pre-qualification stage.

Source: *Wales Audit Office case studies*

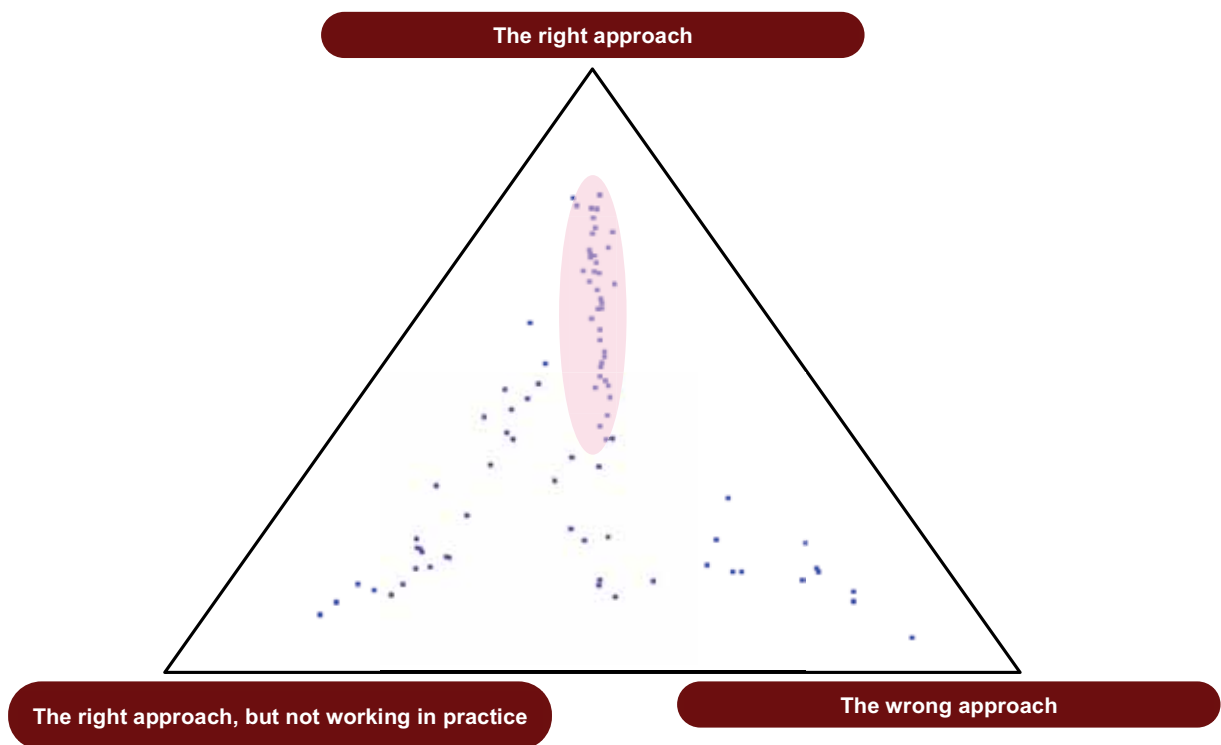
- 3.22 Match funding with procurement has been a particular challenge for some projects. These projects have required bidders to contribute match funding to help meet the overall cost of the project. This raises the risk of cross-subsidy – that European grant paid to the contractor as part of its profit margin is returned to the project as match funding – which would contravene WEFO guidance. Contractors who provide match funding are therefore subject to full procurement and record-keeping requirements as if they were grant recipients. These requirements remove the principal benefits of procurement for delivery agents (profit and streamlined administration) and have made certain contracts largely inaccessible to commercial businesses, since they do not have the resources or the mandate to provide match funding.
- 3.23 Some sponsors have complained about what they felt were unduly onerous procurement requirements, including guidance on the use of the ‘buy4wales’ website run by Value Wales (the procurement arm of Welsh Government). Value Wales guidance recommends only that contracts over £25,000 in value should be advertised on buy4wales. WEFO guidance required project sponsors to advertise all contracts through buy4wales regardless of their value. While the guidance permits other forms of advertising where buy4wales is ‘not the best mechanism’, exactly what this means in practice is not made clear. In reality, project sponsors appear to have felt obliged to procure through buy4wales for even the smallest contracts.
- 3.24 WEFO issued clearer guidance on delivery models in 2010. While there has been no fundamental change in approach, WEFO has modified its guidance to allow competitive grants in a wider range of circumstances. As a result, several projects have switched from procurement to joint sponsorship or grants, which they have found much simpler and easier to use. One notable change has been WEFO’s decision to allow the Wales Council for Voluntary Action (WCVA) to adopt a competitive grant scheme for its Engagement Gateway projects⁴² from March 2011. WCVA reports that the switch in approach has substantially increased the number of applications and dramatically reduced the time between the selection of successful bidders and the conclusion of legal agreements, as the organisation returned to a familiar and less bureaucratic process.
- 3.25 Despite the challenges, our survey of project sponsors and project development officers indicated that a majority of both project sponsors and project development officers supported the move towards competitive procurement in principle, although a significant number felt it was not working in practice (Exhibit 20).

⁴² The Engagement Gateway is a scheme run by the WCVA that provides grants to voluntary organisations to help individuals outside the labour market to become more employable and, if possible, find paid work.

Exhibit 20 – Survey respondents' views on competitive procurement

The survey asked respondents to choose a position between the three statements below. The dots show the number of responses and the shaded area indicates the greatest concentration of responses. The results indicate the balance of opinion among responses and are not intended to be analysed quantitatively.

Formal competitive procurement as the normal way to select delivery agents for projects is:



Source: Wales Audit Office survey of project sponsors and project development officers. Each dot represents one respondent.

WEFO has achieved a high level of compliance with procurement regulations, but the extent to which the increased emphasis on competitive procurement has delivered better value for money and wider access to EU funding is less clear

- 3.26 To date, WEFO has achieved a high level of compliance with EU procurement and State Aid regulations across the 2007-2013 programmes. In contrast, the European Commission has reported that procurement has, more widely, been a major cause of error across EU expenditure on Structural Funds, leading to large financial penalties for some member states. Procurement compliance issues were also a significant cause of error in the 2000-2006 programmes in Wales.
- 3.27 WEFO's 2011 process evaluation found that most project sponsors interviewed thought it was too early to judge whether procurement had improved value for money⁴³. However, several believed that testing the market through procurement had had a positive impact on service quality, for example by enabling the project to recruit a greater range and depth of expertise. A few sponsors also reported that the emphasis on competitive procurement had resulted in a more outcome-focused culture.
- 3.28 Project sponsors had issued almost 2,600 procured contracts worth a total of £1.09 billion by the end of 2013, of which £644 million had gone to the private sector (Exhibit 21). The value of these contracts far exceeds the £22 million of EU funding awarded to project sponsors in the private sector. Direct comparisons with the 2000-2006 programmes are not possible because data on contracts was not collected, but it seems

likely that the extension of procurement as a delivery model has enabled the private sector to deliver a greater proportion of programme funding.

- 3.29 The extent to which SMEs or Welsh-domiciled businesses have been able to benefit from the programmes by partaking in their delivery (as opposed to receiving support as a direct beneficiary) is less clear. WEFO reported to the National Assembly's Finance Committee in September 2012 that 78 per cent of contracts let under the programmes had gone to firms with an address in Wales, but the number of contracts issued to firms head-quartered in Wales, as well as the proportion of programme expenditure accounted for by such contracts, could be significantly lower. WEFO does not routinely monitor the number or value of contracts or sub-contracts going to SMEs or Welsh-based businesses⁴⁴.
- 3.30 Many of the larger sponsor organisations have their own policies to encourage SME participation in public procurement and WEFO's guidance asks sponsors, as a minimum, to complete a sustainability risk assessment based on Value Wales guidance⁴⁵. This guidance requires the sponsor to consider opportunities for SMEs to deliver the contract and to consider practical measures to help SMEs apply. The sustainability risk assessment also promotes the adoption of measures relating to the cross-cutting programme themes of environmental sustainability and equality of opportunity. However, WEFO does not monitor the extent to which such measures are adopted for EU-funded contracts.

⁴³ Generally, comments about procurement in our own survey of project sponsors and WEFO project development officers focused on the difficulties that had been faced applying competitive procurement rather than perceived benefits. Any short-term assessment of value for money benefits arising from competitive procurement needs to take account of the difficulties that have been experienced in implementing that approach.

⁴⁴ In August 2012, the Welsh Government commissioned 'McLelland Review' reported that the Welsh public sector as a whole had made good progress in tackling many barriers to SME participation in public procurement. The review found that the value of contracts going to companies with a base in Wales had increased from around 30 per cent in 2005 to 52 per cent in 2010-11, but concluded that performance was inconsistent across Wales and further progress was possible. John F McLelland CBE, *Maximising the Impact of Welsh Procurement Policy*, August 2012.

⁴⁵ While it is illegal under EU public procurement regulations to discriminate against suppliers on the basis of nationality or locality, there is a lot that can be done within the regulations to help locally based SMEs secure contracts.

Exhibit 21 – Procurement contracts let by project sponsors as at 31 December 2013

	ERDF	ESF	Total
Number of contracts	1,196	1,373	2,569
Of which: Public sector	9%	17%	13%
Private sector	86%	45%	65%
Third sector	5%	38%	22%
Total contract value (£ million)	£565.3 million	£521.5 million	£1,086.8 million
Of which: Public sector	13%	37%	25%
Private sector	75%	42%	59%
Third sector	12%	21%	16%
Average contract value (£000)	£473	£380	£423

Source: WEFO

3.31 As at 31 December 2013, project sponsors had let contracts valued at £178 million (around 16 per cent of the £1.09 billion total value of contracts awarded at that time) to voluntary organisations. In addition, at 31 December 2013 WEFO had approved projects with a total cost of £185 million (£102 million EU funding) to third sector organisations.⁴⁶ The voluntary sector delivered a substantial part of the 2000-2006 programmes and it is not clear whether its overall participation in the 2007-2013 programmes has decreased. The transition to more competitive procurement has also been more difficult for the voluntary sector and the cultural shift from partnership (emphasised in the previous programmes) to competition created some uncertainty about the extent to which organisations could cooperate during the bidding process.

3.32 The average contract value was £388,000 for the private sector and £308,000 for the voluntary sector for the period to 31 December 2013. The relatively modest size of many contracts is likely to have made the majority of contracts accessible to most SMEs and voluntary organisations, subject to their ability to comply with tender requirements.

⁴⁶ The £185m will include money passed on to other voluntary organisations in the form of procured contracts.

WEFO has established a robust system to support project development and selection but sponsors can find the process challenging and time consuming

WEFO has effective mechanisms for ensuring that projects align with strategic objectives, but there is scope to develop a more sophisticated approach for the next round of programmes

3.33 The strategic frameworks that support the operational programmes are one mechanism through which WEFO seeks to ensure that projects address the strategic objectives of each programme. The purpose of the strategic frameworks is twofold: to guide project sponsors in developing projects that meet the programmes' strategic objectives, and to help WEFO select and prioritise projects. Each framework has a strategic framework coordinator who is a Welsh Government official outside WEFO responsible for developing, reviewing and promoting the framework in consultation with partners.

3.34 Our survey findings indicated that project sponsors and WEFO project development officers had a generally positive view of the fit between the programmes and other official policies and strategies, but some felt that the programmes were not always well aligned to local needs. However, a more detailed assessment of local needs would greatly lengthen the strategic frameworks and require more regular updating.⁴⁷

3.35 WEFO's 2009 customer survey found that 94 per cent of respondents used the relevant framework to prepare their applications and 77 per cent found it easy or very easy to determine the relevant framework for their project. WEFO's 2011 process evaluation reported that the strategic frameworks had been invaluable in helping project development officers assess project applications, especially in the early stages of the programmes. The process evaluation also found that the frameworks had helped guide project sponsors towards desired areas of activity and that many stakeholders thought the frameworks had helped establish a more collaborative approach, although they were not the main influence.⁴⁸ However, the evaluation concluded that the frameworks had not, in themselves, fundamentally altered project design and that they had not played a major role in targeting activities towards particular locations.

3.36 The Welsh Government reviewed all the strategic frameworks in 2009 and further changes to some frameworks were made in early 2011. While the process evaluation recommended that they be maintained, the strategic frameworks are seen by many key stakeholders as having served their purpose, and play no significant role in WEFO's on-going programme management and monitoring. We found that some framework coordinators were unclear about the scope of their responsibilities and did not see ongoing monitoring as part of their role, or considered that they did not have the time to undertake such duties. Overall, we found that the coordinators of the smaller thematic frameworks were better engaged with WEFO than spatial framework coordinators.

⁴⁷ Only the spatial strategic frameworks specify local priorities or projects in any detail; the thematic frameworks each have a section on the 'spatial context' which identifies needs and priorities at a high level and is of limited practical use when designing projects.

⁴⁸ The main influences being existing Welsh Government policies, other relevant evaluations, experience with the previous programmes, early messages from Ministers emphasising the need for collaboration and the efforts of WEFO officers during the project selection process.

- 3.37 Several of the framework coordinators that we interviewed commented on the information available from WEFO to track the progress of the frameworks. Most received information on projects approved and in the pipeline, but not on their progress in terms of expenditure and outputs. Consequently they were not always aware of any problems, for example delays, gaps in provision or duplication in activity.
- 3.38 Acting on a recommendation from the Guilford Report, WEFO is developing an *Economic Prioritisation Framework* to support the targeting of the 2014-2020 programmes on key areas of economic opportunity. The draft framework, published in November 2013, lists the main areas of opportunity, existing and planned investments in each area, and the potential for using Structural Funds to maximise the impact of these investments. The aim is help sponsors develop projects that will improve the synergy between existing investments in the Welsh economy and the Structural Funds, thus maximising the impact of the programmes through a more targeted approach. WEFO intends to update the framework regularly to reflect the changes in the economic and strategic context, emerging economic opportunities and progress made on the implementation of the EU programmes.
- WEFO has established a robust system to select projects based on sound criteria, which has improved the quality of project proposals**
- 3.39 WEFO adopted a new approach to prioritise, develop and select projects for the 2007-2013 programmes. Compared with the previous programmes, there is now much closer engagement between the project sponsor and WEFO to help sponsors develop high-quality proposals that meet the requirements of a more demanding assessment regime.
- 3.40 WEFO encourages potential applicants to publish their project ideas on WEFO's website and to collaborate with other interested parties (the pre-expression of interest stage) and considers proposals at an early stage through an expression of interest⁴⁹. The strongest proposals progress to a project development stage and are invited to submit a detailed business plan, which is then subject to further appraisal. In reality, both the EOI and business plan evolve over several iterations. The required content of the business plan (**Appendix 5**) provides a solid framework for assessing the business case of each proposal. An audit by the Audit Authority in 2010 found that procedural weaknesses (with some key documents incomplete or lacking sufficient information or explanation) identified in an earlier audit in 2009 had been addressed. The final decision to approve, reject, or hold in reserve a project is made by a senior WEFO official.
- 3.41 WEFO and the Welsh Government established several forms of support to underpin project development:
- a Starting from the expression of interest stage, WEFO allocates a project development officer to each project to act as the primary point of contact, help the sponsor develop the project and to take the lead on project appraisal.
 - b Other WEFO staff provide expert advice on the cross-cutting themes of environmental sustainability and equality of opportunity, monitoring and evaluation, financial appraisal, communications and compliance issues. Project development officers can also access Welsh Government specialist advice on estates, procurement and legal issues.

⁴⁹ Initially, there were two expression of interest stages but WEFO streamlined the system after employing a business change specialist in 2008 and undertaking a review of the process. That review identified inconsistencies in the approach adopted by project development officers and differences in the time taken to respond to queries or new information.

- c 'Spatial European Teams' encourage collaboration, provide independent support and advice to potential applicants during the development phase, assist sponsors during the implementation phase ('aftercare'), and advise organisations on bidding for delivery contracts in procurement exercises. These outreach functions are provided by a specialist team within the WCVA and 17 teams based in local authorities.⁵⁰
 - d The Welsh Government's Strategic Framework Coordinators also provide specialist policy advice to WEFO staff and project sponsors.
 - e Written guidance is available on WEFO's website.
- 3.42 WEFO assesses project proposals by scoring them as high, medium or low against each of 12 selection criteria (**Exhibit 22**). A project does not need to reach a defined threshold to be approved, although WEFO would not approve a project with several 'low' scores or a low score for one of the key criteria assessed at the expression of interest stage. Following project approval, WEFO will use the scores to identify risks that may need to be managed as part of the monitoring process.

Exhibit 22 – WEFO project assessment criteria

Criteria (type)	Criteria (specific) ¹
<p>Contribution factors</p> <p>The likely contribution that a project will make to programme objectives.</p>	<ul style="list-style-type: none"> • Fit with and contribution to agreed strategy • Extent of partnership engagement • Meeting market needs (evidence of specific market failure or gap in provision) • <i>Contribution to cross-cutting themes</i> • <i>Value contribution (value for money)</i> • <i>Legacy contribution (sustained impact beyond the funding period)</i>
<p>Certainty factors</p> <p>The likelihood that the project will be successfully delivered.</p>	<ul style="list-style-type: none"> • <i>Achievement of projected indicators</i> • Certainty of funding package • Reliable delivery plans in place • Organisational competency and capability to deliver • Clear and sustainable exit strategy • <i>Compliance with relevant rules and regulations</i>

Note:
¹ Following a business process review in 2008, WEFO decided that only those five criteria shown in italics would be assessed at the expression of interest stage. All criteria are assessed during the project development stage.

Source: WEFO

⁵⁰ These teams, and a further five teams based within the Welsh Government, were also intended to contribute towards the development of strategic frameworks, liaise with stakeholders, raise awareness of the Structural Funds, and engage with Strategic Framework coordinators on the monitoring and evaluation of projects.

3.43 In our view, the selection criteria are comprehensive and appropriate. In particular, they represent an improvement on the much more rigid scoring system used to assess ESF projects in the previous programming round, which had a pre-defined threshold for project approval and left much less scope to exercise judgement on the merits of the project plan. In addition, the European Commission has identified WEFO's approach as an example of good practice. WEFO plans to maintain similar criteria for the 2014-2020 programming round.

3.44 Our case studies indicate that WEFO applies the 12 selection criteria flexibly but in sufficient depth to reach a broad-based judgement on the strength of each project proposal. We found several examples where the appraisal process had led to cost reductions, quality improvements or other benefits⁵¹. These included:

- a Scaling back the capital works of a new development without compromising the key benefits of a project. WEFO considered the cost per job excessive when compared with similar projects and negotiated a planned cost reduction of £1.2 million against an original construction cost estimate of £3.9 million. WEFO's also secured several changes to improve the environmental performance of the building concerned, for example through the recycling of 'grey water.'
- b Advising at an early stage on how to integrate equality and environmental sustainability into a project providing support for the marine science industry in Wales.

3.45 However, our review of WEFO's grants to AWEMA found mixed evidence on the effectiveness of appraisal procedures in that particular case. The report found that WEFO had challenged the costs of the three projects that it appraised in 2009 and 2010 and had scaled them back considerably, but had not adequately challenged the organisation's governance and capacity to deliver given previous problems with both WEFO-funded projects and projects managed by other parts of the Welsh Government.

Project sponsors are generally satisfied with the support provided by WEFO, but some find the overall length and complexity of the appraisal process difficult to manage

3.46 The introduction of project development officers, providing a single and continuing point of contact throughout a project's lifetime, has been broadly welcomed by project sponsors. WEFO's 2009 customer satisfaction survey found that 73 per cent of respondents were satisfied with the knowledge of their project development officer and 68 per cent were satisfied with their efficiency. Comments made by project sponsors responding to our own survey were also broadly positive, although some negative experiences were reported regarding inconsistent and inaccurate advice, a general lack of guidance, a level of scrutiny and challenge that did not take account of project sponsors' experience, and the speed of response where project development officers needed to access specialist advice from other WEFO or Welsh Government officials. WEFO's 2009 customer survey found that satisfaction rates were over 50 per cent for all of WEFO's specialist teams, with a relatively high proportion of neutral responses and very low dissatisfaction rates⁵².

51 Responding to our survey, one project sponsor from the higher education sector commented that: 'As a result of the interactions with WEFO during the business plan development stage, we have ended up with a far superior project to the draft project originally submitted'.

52 Project sponsors are encouraged to direct all enquiries through the project development officer. The advice of WEFO teams for the cross-cutting themes of environmental sustainability and equality appears to have been particularly well regarded by sponsors and project development officers. Those teams have been well-resourced. Advice from other specialists has usually taken longer to obtain, often due to resource constraints. Legal advice on compliance with State Aid and public procurement regulations often took several months to finalise as discussions took place on permissible delivery models.

- 3.47 Opinions about other aspects of the support system have varied:
- a Spatial European Teams – An evaluation by WEFO in 2010 concluded that, overall and despite some concerns about capability, the outreach teams based in local authorities and the ESF team based in the Welsh Government had had a positive impact. The teams had extended collaborative working, developing stronger national and regional projects, and had helped potential suppliers bid for procurement contracts. However, the teams based in the Welsh Government had an unclear role and had not added the same value. Acting on the review, WEFO abolished these SETs and maintained support through the outreach teams.
 - b Strategic framework coordinators – WEFO's customer survey in 2009 found that 45 per cent of respondents were satisfied with the service that they received when they sought advice from a strategic framework coordinator and 11 per cent were dissatisfied, but such advice was sought for only 42 per cent of projects at the pre-EOI stage and 51 per cent at the EOI stage.
 - c Written guidance – WEFO's 2009 customer insight survey found that satisfaction rates varied between 39 per cent and 77 per cent depending on the specific guidance, with the lowest satisfaction for the guidance on delivery models, which was subsequently amended.
- 3.48 Changes in programme administration, with many project sponsors and WEFO staff unfamiliar with the new systems, made it particularly difficult to provide effective support during the early stages of the programmes. Some sponsors, particularly in local government and the voluntary sector, were unsure about the type of projects that would be acceptable to WEFO in terms of size, the degree of collaboration expected, and whether WEFO expected the Welsh Government rather than other organisations to sponsor projects in particular policy areas. Guidance on these matters was not always readily available. There were also some early concerns among project sponsors about the time taken by WEFO to process applications, the amount of information requested and the number of versions of business plans that they had to write to address WEFO feedback. In 2009, WEFO issued new and comprehensive guidance to sponsors and project development officers and provided training events on how to write a business plan.
- 3.49 Overall, responses to our survey highlighted mixed views about the design and operation of the system for administering the 'pre-approval' phase, although perhaps unsurprisingly WEFO project development officers were more likely to tend towards a view that the system was well designed and well run. The process leading up to project approval typically takes between at least nine months and often much longer to complete. One private sector project sponsor responding to our survey commented that, as a result of the time taken, their project was already partially complete prior to final approval and that this made it difficult to manage the finance and expectations of sponsors for swift approval of their projects.

3.50 Although WEFO monitors the number and value of projects in the pipeline, it does not formally monitor the duration of each stage of the project development and selection process. The duration of each stage is dependent to a large extent on factors outside WEFO's direct control, and WEFO therefore considers firm targets for appraisal times to be inappropriate. However, the overall efficiency of the process, and the speed with which Structural Funds are mobilised, depends to a considerable extent on the timeliness of the project development process.

3.51 While the length of the process, its administrative requirements, and the extent of feedback from WEFO during the process, have been a source of frustration for project sponsors, we have not identified any clear consensus on improvements that could be made. The process has evolved over time and, in our view, there is no need to fundamentally change the project development and appraisal system for the next programming round, although certain specific aspects of the process could be improved. This should also help to ensure a smooth transition. The Guilford Review similarly concluded that it was preferable to build on existing processes rather than make substantial changes, but suggested testing a project's eligibility and fit with identified economic opportunities at a very early stage. Acting on the recommendations of the report, WEFO plans to introduce a revised approach for the 2014-2020 programmes. Eligibility and strategic fit will be discussed with a sponsor a part of a planning phase before the formal process begins, with more detailed assessment, focusing on delivery risks, taking place once a business plan is received. The planning phase will replace the formal expression of interest and will be a structured conversation between the sponsor and WEFO on the key requirements for the project. The application may be terminated at any point

if WEFO believes that it will not fulfil essential appraisal criteria.

Financial management is sound

WEFO arrangements for managing programme finances operate within a framework of controls set out by the EU

3.52 The European Commission has issued detailed guidance on how financial controls should operate in practice. While not legally binding, there is a risk that the Commission would suspend payments if WEFO did not follow this guidance in any material respect. In addition, the Commission may apply 'financial corrections' (withdrawals of funding from a programme) where it discovers serious infractions of the regulations. It is therefore in WEFO's interest to identify and correct irregularities itself. WEFO also needs to pay grants on a timely basis, obtain reimbursement from the European Commission and ensure that the highest possible proportion of programme funding is spent before the programmes close. This involves managing the risk of fluctuating exchange rates and under-spending projects.

The development of a new IT system has made it much easier for WEFO to manage the programmes' finances

3.53 To support its management of the 2007-2013 programmes, WEFO commissioned a new web-enabled IT system, known as PPIMS.⁵³ The system was introduced in June 2008 as the first projects were being developed. Some of the functionality of the system had to be scaled back initially following substantial cost over-runs, but most of these functions have now been restored and the system is working smoothly. The system enables:

⁵³ We have not examined the procurement or any other aspect of this project in detail as part of this study. Further detail on the PPIMS project is available in the Wales Audit Office report, *The Delivery of ICT Services and ICT Projects under the Merlin Contract*, August 2011 (Case Study 1, page 42).

- a applicants to submit expressions of interest, business plans and delivery plans electronically;
 - b sponsors to submit grant claims electronically, with many of the calculations now automated, and receive funds much more quickly than before;
 - c WEFO staff to file documents electronically in a standardised system, largely doing away with paper files, and to save time by processing grant claims and other information electronically; and
 - d WEFO managers to obtain a wide range of management information more quickly than before, helping them to improve forecasting and draw down money from the European Commission more quickly than before.
- 3.54 WEFO estimates that the new system has led to annual efficiency savings in its own administration of just under £277,000 compared with the one-off capital cost of £18.1 million and annual running costs of around £1.25 million per year. Savings for project sponsors have not been assessed, and are difficult to evaluate given other changes that have made reporting requirements more onerous generally. WEFO considers that the main benefit of the PPIMS system has been to strengthen programme management by improving the quality and timeliness of important management information. This in turn has practical benefits for forecasting, reporting and claiming reimbursement from the European Commission. The European Commission cites the system as a benchmark for other managing authorities because of the range of functions that it has. WEFO is confident that it will be able to continue using the system for another eight years with little additional investment required.

WEFO pays grants on a timely basis after making appropriate checks and has recently strengthened controls over advance payments

- 3.55 The WEFO payments team is responsible for checking claims, making payments and chasing overdue claims to ensure that programme funding is paid out on a timely basis. Payments are normally made in arrears but voluntary organisations may receive advances against future claims based on estimated expenditure. Basic verification checks are automated through the PPIMS system. There are two levels of additional checks:
- a WEFO's payments team undertakes desk checks to ensure that claims appear reasonable. Each claim is supported by a list of transactions that is reviewed for any items that may be ineligible, and since mid-2012 sample checks are made to supporting documentation to confirm that costs are genuine and have been paid.
 - b Each sponsor contracts with an independent external auditor, known as a reporting accountant, to perform an annual audit and report to WEFO on the adequacy of controls and whether claimed expenditure in the period was eligible and correctly stated. The Wales Audit Office undertakes these audits for most projects. On receipt of the auditor's report, WEFO will seek to resolve any issues raised by the auditor and adjust the next payment of grant to adjust for any errors found.

- 3.56 The level of scrutiny is much higher than during the previous programming round, helped by the smaller number of projects in the current round. The Audit Authority (the Welsh Government's European Funds Audit Team, which exercises audit functions on behalf of the European Commission) has reviewed the payments system and concluded that it is effective.
- 3.57 In 2012, WEFO strengthened controls over the payment of advances to third sector organisations after losing most of the £300,000 of European funding provided to AWEMA, which became insolvent after receiving advances but not spending the money on approved project activity. This is an inherent risk with advance payments. WEFO now requires a voluntary organisation to prove that it needs advance payments in order to fund the project and had tightened approval procedures and conditions of grant to reduce the risk that funding will be lost or not passed on to contractors on a timely basis.⁵⁴
- 3.58 The process of compiling a claim that meets the standards required by the regulations is quite onerous for sponsors and there is a risk that late or understated claims reduce the amount that WEFO can claim from the European Commission, affecting performance against spending targets and potentially resulting in the de commitment of programme funding. Overall, however, the record is reasonably good: sponsors make around 80 per cent of their claims on time (within three weeks of the end of the quarter to which the claim relates) and most of the rest are no more than a few weeks late. The payments team chases overdue claims regularly and pays around 90 per cent of claims within its target period of four weeks from receipt. WEFO's customer survey in 2009 found that 72 per cent of respondents were satisfied or very satisfied with the time taken to pay grant claims.
- 3.59 The 'Certifying Authority' is a division within WEFO that is responsible for submitting reimbursement requests to the European Commission after making appropriate checks to ensure that only legitimate expenditure is included. The Audit Authority has reviewed the Certifying Authority's systems and controls and is content that they are effective.
- WEFO is in a good position to manage fluctuations in the exchange rate and other financial risks as the programmes draw to a close**
- 3.60 Because WEFO makes commitments and payments to project sponsors in sterling, but is reimbursed by the European Commission in euros, WEFO realises a gain or loss based on the difference between the exchange rate when a payment is made to a project sponsor and when the EU funds are actually drawn down. These gains and losses can be considerable due to the volatility of the exchange rate and the time that elapses, which can be several months. WEFO did not start making payments until 2009, after the value of the euro had reached its lowest point and, since that time, the trend of a strengthening pound has tended to result in losses totalling £5.9 million in 2010, £6.6 million in 2010 and £5.8 million in 2011. However, WEFO made a gain of £655,000 in 2012, reflecting the benefit of a weakening pound in the second half of the year and WEFO's decision to make more frequent reimbursement requests to the European Commission. The trend continued into 2013 with exchange gains of £4.6 million expected for the whole year.

⁵⁴ Wales Audit Office, *The Welsh Government's Relationship with the All Wales Ethnic Minority Association*, October 2012, paragraphs 3.37 (loss of funding) and 3.49 (strengthening of controls). Paragraph 3.37 reports that WEFO paid £301,614 more than was claimed, and irrecoverable ineligible expenditure raised the total loss to around £405,705.

3.61 Should the value of the pound weaken during 2014 and 2015, WEFO could find it difficult to ensure that the programme budgets (set in euros) will be fully used by the time the programmes close in 2015. Conversely, should the pound strengthen, WEFO may have to cancel or scale back some projects or find money from Welsh Government resources to meet the full cost of approved projects. This would be difficult to deal with if it occurred at a very late stage, but WEFO could, if necessary, fund ongoing operations through the new 2014-2020 programmes provided that project approval procedures are in place. That projects have a tendency to under-spend against their original budgets, further complicates the task of ensuring that the programmes are fully spent.

3.62 WEFO's current policy is to commit more than the current sterling value of the programme allocations to allow for under-spending by projects and the implications of any significant strengthening of the value of the pound. Based on experience of the 2000-2006 programmes, WEFO plans to over-commit the ERDF programmes by five per cent and the ESF programmes by 10 per cent. The ERDF programmes have more capital projects that are considered much less likely to under-spend than revenue projects. WEFO used a similar approach successfully for the 2000-2006 programmes, ensuring that 97 per cent of available EU funding was spent despite the unexpected strengthening of the euro in the two years before the programmes closed in 2009.

WEFO has generally effective financial management systems to ensure compliance with EU regulations, but they can be a heavy administrative burden for sponsors

3.63 The Audit Authority has concluded that WEFO's management and control system provides for effective controls and that WEFO's organisation and procedures complied fully with the relevant EU regulations. The Audit Authority has an audit strategy that involves assessing all of WEFO's important management systems over the programming period to ensure that they are operating effectively in practice. The outcome of the systems audits to date has been good: most systems were found to be working well and recommended improvements were made within 12 months. The Audit Authority has issued unqualified audit opinions (in other words, that controls are effective) in each of its annual control reports to date.

3.64 The Audit Authority is itself subject to audit by the European Commission. The Commission issued three mostly positive audit reports for the current programmes, but has recently raised concerns over the sampling methodology used by the Audit Authority to select projects and transactions for audit testing and the basis on which it had calculated the projected error rate. In common with several other regions of Europe, the Audit Authority has hitherto used a random non-statistical sampling methodology, but the European Commission is now enforcing recently issued guidance that recommends a statistical approach based on monetary unit sampling. Work to recalculate error rates on the basis of statistical sampling is ongoing. Pending completion of this work, and as a precautionary measure, the Commission temporarily interrupted

ERDF payments to WEFO in December 2013. Latest indications are that error rates remain low overall in Wales and the Welsh Government is optimistic that the issue will be speedily resolved.

3.65 WEFO's systems include a series of 'management verifications' to ensure that projects are complying with their obligations and to detect errors before the related expenditure is declared to the European Commission. As required by EU regulations, these verifications comprise:

- a 'administrative verifications' on all claims to ensure that they are correctly calculated, match funding has been received and costs are eligible and supported by invoices; and
- b 'on the spot' verifications to confirm that projects are taking place in line with the conditions of the grant and to confirm compliance with requirements that cannot practically be assessed at claims stage, for example full compliance with procurement and publicity regulations.

3.66 The administrative verifications comprise the work of the Payments Team and external auditors, known as reporting accountants (usually the Wales Audit Office) acting under WEFO's instructions. WEFO's project inspection and verification (PIV) team undertakes the 'on the spot' verifications. The PIV team also reviews the sponsor's system of controls and tests transactions in a similar way to the external auditors. The PIV team aims, over the programming period, to visit the first project of each project sponsor and to assess 50 per cent of the remaining projects on a risk-based sample basis. The PIV team has strengthened its procedures and is in the process of up-skilling staff in response to criticism from auditors

about its sample selection, documentation, quality of work and procedures for following up recommendations.⁵⁵ In addition, the PIV team now reviews general financial controls, governance arrangements and financial viability in those projects in which WEFO has identified a specific risk in these areas.

3.67 In addition, the Audit Authority audits a sample of projects each year to confirm that expenditure claimed by WEFO is valid and correct. The sample covers all projects that account for more than two per cent of the funds drawn down by WEFO and at least 10 per cent of other projects. The EU's own auditors and the European Court of Auditors may also audit WEFO's management systems and individual projects, although such audits are uncommon and much less extensive than the work of the Managing and Audit Authorities.

3.68 These controls are supplemented by extensive written guidance and by training courses for project sponsors on the audit process and how to comply with the main regulations. Training was originally restricted to Welsh Government staff but has since been extended to other sponsors.

3.69 The qualification rate – the rate of errors or potential errors found by reporting accountants – was 0.44 per cent of audited expenditure up to 30 September 2013, an encouraging reduction from the 1.09 per cent when the figures were first reported in August 2011. This was the residual error rate once any corrective work, which is sometimes extensive, had been undertaken. The total error rate identified by WEFO's management controls was 0.65 per cent up to the end of September 2013. Common problems found in management verifications⁵⁶ include:

55 Concerns raised in reports by European Commission auditors (November 2009) and the Audit Authority (April 2010). A follow-up report by the Audit Authority in June 2010 found that the recommended improvements to procedures had been made, and the team was assisting most of its staff to obtain professional audit and accountancy qualifications.

56 WEFO's Delivery and Compliance Group, report to the Programme Monitoring Committee, June 2013.

- a **Ineligible expenditure:** relatively small amounts claimed for services that are not covered by the Programmes or for payments that had not been made or were outside the project period.
 - b **Indirect costs** calculated incorrectly. The process of apportioning overheads to projects can be complicated and must be done using a method approved by WEFO, with overhead rates updated throughout the project. WEFO has tried to simplify the process for sponsors by approving flat-rate overhead costs for sponsors in the higher education sector [and plans to extend this practice to other sectors].
 - c **Timesheets** are required to support the costs claimed for staff who work part-time on a project, but are sometimes not kept, meaning that the related staff expenditure is deemed to be ineligible.
 - d **Document retrieval:** there has been an increasing problem of projects failing to retain all the documents that are needed to support their grant claims.
- 3.70 Recently, WEFO has identified an emerging problem of some sponsors not being able to provide adequate evidence that they have complied with EU procurement regulations, and some others not being able to support their claimed outputs. Nevertheless, the overall error rate is relatively low and the problems outlined above do not reflect fundamental weaknesses that would jeopardise the delivery of the programmes. The management verifications are effective in reducing the rate of errors in expenditure declared to the European Commission (i.e. after correction of errors found by reporting accountants): the projected error rate identified by the Audit Authority's testing

of project expenditure was only 0.36 per cent for 2012 (the latest year for which figures are available), a reduction from 0.46 per cent for 2011 and well below the materiality threshold of two per cent set by the European Commission. This position contrasts favourably with managing authorities elsewhere in the UK and the EU, some of which have suffered suspensions of payments and/or major financial penalties because of errors found by audit authorities. The current programmes have not been the subject of any financial corrections to date, unlike the previous programmes for which financial corrections of around £19 million in grant were made by the European Commission in 2005⁵⁷.

- 3.71 While WEFO's system of financial control is effective, it imposes a heavy administrative burden on sponsors. The requirements are significantly more demanding than for wholly Welsh Government-funded programmes and the audit regime is more stringent. For example, the Audit Authority checks compliance with public procurement regulations in much greater depth and any infractions identified by the European Commission attract a fixed financial penalty for the relevant managing authority, which may be passed on to the sponsor.
- 3.72 Our survey of project sponsors and PDOs indicated some frustration among sponsors with the nature and extent of the rules and the time-consuming audit and inspection processes. Several respondents commented on the difficulty of getting useful and timely answers from WEFO on compliance questions, for example on whether particular costs were eligible. The survey responses indicate that both sponsors and WEFO are anxious about making a wrong decision that could result in funds being reclaimed by the EU, but the resulting caution can lead to frustrating uncertainty and delay.

⁵⁷ A financial correction is a reduction in grant claimed from the EC to reflect errors or procedural weaknesses. The correction may be requested by the managing authority itself, in which case the total funding available is not reduced and the money lost through the correction can be recycled into other projects, or imposed by the European Commission following an audit, in which case the funding allocation for the programme is normally reduced. In 2005 WEFO self-reported and the EC accepted the correction without reducing the funding available to the programmes.

- 3.73 There was also some concern about the duplication of audit procedures by the PIV team, the external auditors and the Audit Authority. While the focus and purpose of each of these control mechanisms is different, they all involve assessment of controls and many of the tests they perform are the same or similar. The largest projects will be audited at least twice each year, once by the Audit Authority and again by the project's own reporting accountant. Other projects will be audited by their reporting accountant annually but are much less likely to be inspected by the Audit Authority or the PIV team as part of their sample testing of expenditure.
- 3.74 WEFO's scope to resolve this duplication and to reduce the overall administrative burden is constrained by the EU regulations and the guidance produced by the European Commission. Nevertheless, there is some scope to reduce overlap. For example, the tests undertaken by the payments team since 2012 (introduced following a recommendation by the Audit Authority) duplicates some of the work done by the reporting accountants. The guidance specifies the type of management verifications that need to be done, but it does not specify that they need to happen more than once. It should be possible, therefore, to reconsider how this recommendation for an improvement in front-line controls can be implemented so that inspection work is not in danger of being duplicated.
- 3.75 In response to WEFO's consultation in February 2013 on implementation arrangements for the next programming period, we suggested a number of practical measures to improve the audit regime arising from our experience as reporting accountants, such as tailoring the level of testing more closely to risk, better exchange of information between WEFO and the reporting accountants, and ensuring the timely provision of training to all appropriate staff at project sponsors.

Performance is better managed than under the previous programmes but could be tighter in some respects

- 3.76 WEFO has a clear system to manage performance at the programme level. The Programme Monitoring Committee meets three times a year to consider overall progress and receives comprehensive reports covering the progress against commitment, expenditure and output targets for each programme and any 'significant implementation issues', such as the challenge of managing exchange rate risks and ensuring that sufficient match funding is available. Indicator data is reported in great detail, but the monitoring reports do not assess the results in depth, for example to consider the extent to which the programmes are succeeding in increasing participation among disadvantaged groups.
- 3.77 Day-to-day management is the responsibility of the Programming and Performance Board, which comprises the Director of WEFO and four other senior WEFO officials. The Board reviews progress against the main performance indicators at both a programme and project level, including consideration of any irregularities identified through audit and inspection work, and makes operational decisions on the management of the programmes. Key decisions are subject to Ministerial approval where appropriate.
- 3.78 The Project Development Officer takes the lead in monitoring the progress of individual projects. WEFO guidance stipulates that an inception meeting should be held with each sponsor within three months of project approval followed by regular progress reviews no more than six months apart. The review process may ultimately result in funds being withdrawn from a project if it is consistently under-performing and unlikely to recover ground before the end of the programmes.

3.79 WEFO makes frequent use of special conditions in grant approval letters to deal with risks that are specific to a particular project. For example, WEFO might require an interim project evaluation or make approval for a capital project subject to planning consent or an environmental assessment. Special conditions are monitored as part of the project review process and help WEFO to manage project risks effectively by highlighting key issues for the project sponsors and WEFO officials.

3.80 Overall, performance management is more robust at a project level than the previous programmes, where WEFO did not have the capacity to closely monitor the progress of the many projects that came to exist over the life of the previous programming round. However, our review of project files indicated that problems with slow progress in delivering projects was not always adequately explained or consistently recorded on PPIMS during the early stages of programme delivery in 2009 and 2010. Inception and progress meetings were not always held within the timescales envisaged in WEFO's own guidance and progress reports did not explain in any detail the reasons for project slippage and how the situation would be recovered. In some cases, action by WEFO was restricted to asking the project to re-profile their expenditure and outputs to account for slippage, and some projects re-profiled several times until WEFO decided to limit re-profiling to twice during a project's lifetime.

3.81 Nevertheless, matters appear to have improved as WEFO's systems and projects themselves have become better established. A report by the Audit Authority in December 2011 found that system of progress reporting and monitoring was essentially sound but recommended improvements in documentation and more regular

monitoring of special conditions with a long time-span.⁵⁸ In its response to the Auditor General for Wales' report on AWEMA, in which similar issues were raised, WEFO undertook to review the application of its guidance and to ensure that all substantive contact was recorded consistently. This is important as the frequency of meetings may be reduced if projects are well established and performing well, or communication may be in writing rather than face-to-face.⁵⁹

WEFO has strengthened monitoring and evaluation arrangements and developed more robust approaches to measuring impacts, but data quality remains a concern

There is clear accountability for monitoring and evaluation, with appropriate expertise and resources

3.82 WEFO has developed a Monitoring and Evaluation Strategy for the 2007-2013 programmes that is supplemented by an evaluation plan that is regularly updated. The key features of the strategy are:

- a Regular monitoring of outputs and results at programme level.
- b Programme level evaluations, focusing initially on processes and systems, and later on the effectiveness and impact of activities.
- c Strategic framework and project-level evaluation. Each strategic framework will be required to implement a monitoring and evaluation plan, while all projects will be required to undertake their own evaluations in accordance with a business plan agreed with WEFO.

⁵⁸ The Auditor General's report on AWEMA also noted that special conditions were recorded as open on WEFO's project management system long after they should have been closed.

⁵⁹ Welsh Government, Written evidence for the Public Accounts Committee on the Wales Audit Office's Report on the Welsh Government's relationship with the All Wales Ethnic Minority Association (AWEMA), Public Accounts Committee of the National Assembly for Wales (PAC (4) 28-12 paper 1), December 2012.

- d Resources in the form of a dedicated Research, Monitoring and Evaluation (RME) team, which includes several staff with specialist research skills. WEFO has also established an independent group of experts, the Evaluation Advisory Group, to advise and assist WEFO in undertaking these functions. Evaluations are part-funded by the Structural Funds: in the form of technical assistance for programme-level evaluations, and as an allowable cost for project evaluations.
- e Specific reports required by the European Commission for each programme. These include an ex-ante evaluation (an assessment of the socio-economic needs of the area at the start of the programming period), annual implementation reports covering prescribed topics, and an ex-post evaluation summarising the effect of the programmes.

There is a coherent set of indicators for measuring the success of the programmes at each stage of development but the full employment impact of the programmes is not captured

3.83 Effective evaluation depends largely on access to reliable data about the outputs and results of the programmes as they are delivered. WEFO has also agreed a series of impact indicators with the European Commission to complete the 'logic chain' (outputs leading to results, leading to impacts) to measure the long-term impact of the programmes. The indicator set provides a comprehensive framework for assessing the progress and impact of the programmes at each stage. A study in 2010⁶⁰ concluded that 'WEFO's monitoring data represent a valuable source of data for undertaking some sophisticated evaluation work, in particular at project level' and

that the structure and content of the monitoring database 'appears to be comprehensive and is continuously improving.'

3.84 WEFO has reduced the number of indicators considerably compared with the previous programmes, in line with European Commission guidance that a streamlined indicator set is more manageable for project sponsors and more likely to yield consistent, high quality data. The smaller number of indicators does not fully capture the progress or impact of the diverse range of activities funded, especially for the ERDF programmes. For example, physical regeneration schemes are often multi-faceted projects and certain aspects, such as environmental improvements, will not be captured by the approved indicators. European Commission guidance emphasises the importance of projects using their own indicators, in addition to those prescribed by the operational programmes, to assess how well they are meeting objectives.

3.85 WEFO has clearly defined most of the monitoring indicators in published guidance, including setting out related record keeping and reporting requirements. Definitions have been tightened for some indicators for the current programmes to set minimum levels of provision and prevent inflated claims on project outputs; for example, a project cannot count a business against the 'enterprise assisted' indicator unless it has provided at least £2,000 worth or 14 hours of support. The guidance remedies a weakness noted in evaluations of the 2000-2006 programmes, when many projects were uncertain about indicator definitions and evidence requirements.

⁶⁰ DTZ Consulting, *A feasibility study of methodological approaches to undertake impact evaluation of 2007-13 Structural Fund Programmes in Wales*, report commissioned by WEFO, September 2010 (p102 and p104).

- 3.86 A key indicator for the ERDF programmes is jobs created, as both a result (gross jobs created) and an impact (net jobs created, after adjusting for the effect of external factors). As in the previous programmes, there are some problematic issues with jobs created:
- a It is not always clear whether jobs have been achieved through Structural Funds support, especially for business support projects which account for around 80 per cent of jobs attributed to the programmes. Sponsors count all jobs created by business start-ups and most other jobs created by firms that have received advice or financial assistance. The RME team reviews the data submitted by sponsors and removes claimed jobs that do not appear to be realistically attributable to ERDF although it is still likely that a significant proportion of the remaining jobs would have been created without ERDF support. WEFO uses the ERDF Business Survey to assess the net impact of the Funds.
 - b WEFO does not count jobs safeguarded, temporary jobs that are expected to last less than 12 months, or jobs in project administration; and until March 2012 did not count fixed term appointments of more than 12 months on the basis that the Structural Funds aimed to create sustainable, permanent jobs. These restrictions mean that, other factors being equal, the full effect of Structural Funds on overall employment will not be captured by the indicators. The ERDF Business Survey in 2012 found that the number of safeguarded jobs was significant, while temporary jobs (eg, in construction) and jobs in project administration are also likely to be as significant. Subsidised job placements provided by ESF projects may also have a sizeable impact on overall employment levels, albeit temporary. It is important, however, to measure these categories of jobs separately as they are of variable social and economic value, with new permanent employment having the highest value.
 - c The quality and sustainability of employment is not measured on an ongoing basis, although quality is assessed through evaluation. Sponsors must report on each post (not the individual who fills the post), which is appropriate, but there is no check to ensure that the post is sustained, for example that it still exists after 12 months. Salary information is required as a proxy for job quality but skill level is not reported.
- 3.87 The profit benefit indicator was introduced for the current programmes to measure the additional profit arising from savings or productivity benefits achieved with EU support. However, performance has been disappointing, and WEFO attributes this largely to difficulties in measuring profit benefit – figures will often depend on estimates and accounting judgements – and a reluctance on the part of small businesses to pay for professional help in calculating the profit. More detailed guidance with specific examples would be helpful to encourage beneficiaries and sponsors to measure profit consistently and comprehensively. An alternative indicator like gross value added or increase in turnover might be more easily measurable for most beneficiaries and would better capture the financial benefit of general business support.

- 3.88 Result indicators for the ESF Convergence public service reform measures are inconsistent with other results indicators as they are more akin to outputs than outcomes. For example, the indicators include participants completing courses, progression schemes for women, secondment placements, workforce planning and development strategies developed.
- 3.89 Several ESF projects are designed to improve the employability of participants and this often involves developing personal attributes such as confidence, self-esteem, interview skills and softer workplace skills such as communication and teamwork that are not captured by the 'hard outcomes' measured by the monitoring indicators. Such improvements or 'soft outcomes' may not lead to 'hard outcomes' such as employment or qualifications immediately, but it is expected that they will do so in due course.
- 3.90 Soft outcomes can be difficult to measure but WEFO has a target that 50 per cent of ESF projects in the relevant Priorities⁶¹ should use soft outcome measurement systems. However, at the end of 2013, only 14 of the 50 approved projects had such systems in place. Furthermore, WEFO does not require a measurement system to cover all relevant activities within a project. An independent evaluation of ESF Convergence Priority 1 in 2012 found that missing data and inconsistent use of measurement tools (both between and within projects) made it difficult to assess soft outcomes, although participants had highlighted significant benefits to their confidence and softer skills.
- 3.91 WEFO reports against the tracking indicators (for example, overall employment and unemployment rates in the programme area) in each Annual Implementation Report. The tracking indicators have limited value as a monitoring tool because it would be misleading to compare gross monitoring data (rather than net impact data) with changes in each tracking indicator, which are caused by a wide range of factors. However, it would be more valuable to compare estimates of net impact derived from evaluation with the movements in the key tracking indicators to assess whether the programmes have made a significant positive contribution to socio economic trends.
- WEFO has improved the collection of monitoring data but some aspects of data quality remain a concern**
- 3.92 **Data is collected on a consistent basis for all projects.** Projects are required to select all relevant indicators in the operational programme for the priority under which they are funded, thus ensuring that information is collected on a consistent basis across the programmes. Data on both outputs and results are collected regularly and reported to WEFO by project sponsors using WEFO's online claims system, which is connected to PPIMS and enables efficient data collection and analysis. All output data for projects run by the Department of Economy, Science and Transport is drawn from a single database that was re-designed at around the time the 2007-13 programmes were launched, and the system uses the same definitions for outputs and results as those specified for the EU programmes.

⁶¹ ESF Convergence Priority 1 (supplying young people with skills for learning and future employment) and ESF Convergence Priority 2 and ESF Competitiveness Priority 1 (increasing employment and tackling economic inactivity)

3.93 The accuracy of monitoring data is audited by WEFO's project inspection and verification team and indicates that reported data is accurate at project level, but problems remain in some respects of data quality:

- a **The quality of participant level data:** WEFO now requires projects to submit information about each organisation or individual supported by the programmes. These details include the age, gender and labour market status of ESF participants and the size, ownership and staffing of companies supported by ERDF. However, the quality of detailed records is variable and many of the necessary details are missing or inaccurate. This has made it problematic to analyse monitoring data by category of participant or business and has hampered the conduct of the ERDF Business Survey because it has not been possible to match assisted companies to databases maintained by other Government departments.
- b **Double counting of outcomes:** evaluations for the previous programmes found that double-counting was a significant concern because many beneficiaries received support from several EU-funded projects, and there were no controls to prevent each project claiming the same outcome. WEFO has issued guidance to ESF projects where individuals take part in more than one ESF project. Each project should count all their participants, but only one project may claim for the same result (eg, a qualification gained or entry into employment) and the relevant

projects need to liaise to establish which one claims the outcome. However, the mechanism for enforcing this guidance at project level is unclear. There is no guidance for ERDF projects, although the risk for business support projects, where firms may receive support from several sources, is similar to that for ESF participants. The participant database should allow WEFO to identify and correct double-counted outcomes, but the work is likely to be laborious especially if data quality is poor. At present the extent of double counting is unclear.

- 3.94 WEFO has developed its own participant and business databases from the records provided by sponsors, which may be uploaded from spreadsheets or from links with the bigger sponsors' own databases. Whilst the databases function reasonably well, a database that allowed sponsors to submit individual records directly and online would reduce administration costs for WEFO (although the initial development would be costly) and help improve data quality. An interactive database could be programmed to require all relevant details before records could be submitted and to alert sponsors if another project was claiming a result for the same individual. WEFO decided not to develop such a database at the outset of the current programmes in response to feedback from sponsors that wished to maintain existing systems that adequately met their own needs. An interactive database would need to be compatible with these systems to avoid costly double-entry of data, and would need to operate within the constraints of data protection legislation that restricts data sharing.

WEFO has strengthened evaluation arrangements, but comprehensive information on project-level impacts is likely to emerge only towards the end of the programmes

3.95 **WEFO plans a series of thematic evaluations that will cover the main aspects of programme administration and delivery.** The European Commission requires managing authorities to evaluate the programmes on an ongoing basis in response to policy and programming needs. As part of its commitment to ongoing evaluation, WEFO has commissioned:

- a A series of studies on the process and systems for implementing the programmes. These include a customer satisfaction survey; a process evaluation that looked at strategic frameworks, cross-cutting themes and communications; a review of the Spatial European Teams; and research into the feasibility of various approaches to evaluating the impact of the programmes.
- b Eight evaluations, known as priority or strategic framework evaluations, to evaluate key areas of programme activity. The interim evaluations consider the extent to which the relevant strategic frameworks are relevant to the needs of the programme area, how well the programme is working as a mechanism for delivering programme objectives and progress against monitoring indicators. Two interim evaluations and a synthesis of the remaining evaluations was published in 2013. The interim reports will be followed by final evaluations towards the end of the programmes which consider impact in more depth than is possible at interim evaluation stage.

3.96 In addition to these programme evaluations, all projects are required to undertake their own evaluations, which must be commissioned from an independent and external source if the project receives more than £2 million in grant or is otherwise considered high risk. The vast majority of projects will, therefore, need to commission external evaluations, in contrast with the previous programmes when most projects did not commission external evaluations and many did not evaluate at all. Some larger projects are asked to provide interim evaluations as a special condition of their grant approval letter, but WEFO does not always enforce such conditions effectively. At 31 December 2013 WEFO and the Welsh Government had published 36 project evaluations on their websites.

3.97 WEFO has issued generic guidance on evaluation and provides advice on each project's monitoring and evaluation plan at project development stage. Each strategic framework has a set of common evaluation questions that each project evaluation is expected to answer, to help ensure that evaluations seek to answer the same questions when projects have similar objectives. WEFO also reviews project evaluations for quality before publishing them on its website. All these were new developments for the current programmes and represent a strengthening of procedures on evaluation.

WEFO has developed a more sophisticated approach for assessing the net impact of the programmes

- 3.98 WEFO seeks to evaluate impact on an ongoing basis through the ESF Leavers' Survey and the ERDF Business Survey. The Leavers' Survey is annual and has taken place since 2010. It asks a sample of participants who have completed ESF provision within the year before the survey about the skills and qualifications they have gained and their employment history since they left their course or placement. The ERDF Business Survey was conducted in 2011 and WEFO intends to repeat it every two years. It asks businesses that have received ERDF support about the nature of their business and the effect that ERDF support has had on their turnover, employment, profitability, exports and degree of innovation.
- 3.99 Impacts will depend on a range of external factors that will tend to reduce the results reported by projects and the measurement of these impacts is often difficult and complex. Historically, the impact of economic programmes has been evaluated using a combination of primary research (asking recipients about their perception of impact) and estimating wider economic effects using standard discount factors derived from input-output tables.⁶² However, input-output data is often dated and self-reported perceptions of impact may also be unreliable as a guide to actual impact.
- 3.100 To overcome these problems, WEFO commissioned research from DTZ consultants in 2010 on the feasibility of adopting different approaches to evaluating impact at the programme level. Based on the findings of the research, WEFO has piloted the use of econometric analysis for the ESF Leavers' Survey and the ERDF Business Survey. Econometric

analysis compares outcomes between a treatment group (those receiving EU funding) and a control group (as similar as possible to the treatment group but not receiving EU funding). Any difference in performance between the two groups, after adjusting for any structural difference, would be attributable to the impact of the Structural Funds.

- 3.101 The econometric analysis has worked reasonably well for the ESF Leavers' Survey. Despite some methodological difficulties, the evaluation has been able to compare the results of leavers with a control group drawn from the Labour Force Survey and to estimate net impact on that basis, yielding results that the evaluation contractors consider reasonably robust. As the volume of data has increased WEFO has been able to extend the analysis to examine the impact by gender, labour market status and for particular types of intervention.
- 3.102 On this basis, it is theoretically possible to extrapolate impacts across the programmes using WEFO's monitoring data. However, WEFO uses a narrower definition of unemployment (Jobseekers' Allowance claimants) than that used by the ESF Leavers' Survey and Labour Force Survey, which both adopt a broader definition that encompasses people seeking work but not claiming benefit. This broader definition, which is used to calculate the headline unemployment rate, typically increases the number of unemployed by around two-thirds. The broader definition is more appropriate to distinguish between those who are actively seeking work and those who are, in reality, economically inactive. By adopting a narrow definition of unemployment, WEFO's monitoring data is likely to overstate the proportion of participants who are economically inactive and most difficult to bring into the labour market.

⁶² Input-output tables are official statistics that show how each industrial sector consumes the outputs of every other sector, in other words where each sector sells its products and where it buys its materials (inputs) from. Together with survey evidence, the tables enable an evaluation to estimate the scale of displacement, deadweight and multiplier effects and to reduce the reported gross results accordingly, giving an estimate of net impact

- 3.103 The econometric approach has been less successful for the ERDF Business Survey. The aim was to compare the performance of ERDF recipients with a group of similar businesses from the Inter-Departmental Business Register (IDBR) and Financial Analysis Made Easy (FAME) databases – both major databases of companies trading in the UK. To make an effective comparison, the evaluation needed to identify the ERDF recipients within each database to obtain details of their financial and employment history, and compare that with a control group drawn from the same database. However, the analysis was hampered by several problems:
- a the contractors could not find many of the ERDF recipients within the databases because important details such as company name, address or VAT number in WEFO records were missing or inaccurate;
 - b many ERDF recipients were small firms that did not have to file full accounts, so there was not enough financial information on them to make a comparison with a control group using FAME; and
 - c many start-up companies assisted by ERDF had not yet appeared in the IDBR, meaning that a control group could not be created for a large proportion of ERDF supported businesses.
- 3.104 These major hurdles could not be overcome and the Survey had to rely on self reported impacts as described in [paragraph 2.63](#). Nevertheless, the Survey concluded that it was feasible to use the databases over time to compare the performance of larger businesses and to compare survival rates of a much wider range of businesses, provided that the quality of WEFO's records improved.
- 3.105 Overall response rates were 34 per cent for ESF and 40 per cent for ERDF. Much of the non-response was due to incorrect contact details for sampled participants. In addition, both surveys had significant refusal rates (respondents refusing to take part) and non-recall rates (respondents who could not remember receiving any assistance), especially for the ERDF Business Survey. European Commission guidance recommends that employment effects are monitored on an ongoing basis so that evaluation data is captured as soon as reasonably practical after the programmes' support is provided (time needs to be allowed for the support to have an impact). WEFO undertakes the ESF Leavers' Survey annually, and it may be worth conducting the ERDF Survey at annual intervals also in order to improve the reliability of survey data.
- 3.106 Much of the value of the two surveys lies in linking the findings to particular types of intervention so that the relative benefits of each type can be assessed. WEFO has been able to do this for the ESF Leavers' Survey, but the ERDF Business Survey is not yet at the stage where this would be possible. At present, there is no mechanism to feed the results of the Surveys into project evaluations, although the ESF Leavers' Survey has been used in the evaluation of ESF Convergence Priority 2 (tackling economic inactivity).
- 3.107 Project-level evaluation remains necessary to gain a more detailed insight into the impact of particular services and how they lead to impacts. Projects have autonomy in selecting evaluation contractors and deciding on evaluation methods. Such autonomy makes it easier to design an approach that suits a particular project and to compare different approaches. However, a more coordinated approach has

many potential benefits: greater economies of scale by commissioning bigger evaluations and/or using more ambitious research methods, more scope to share good practice and compare projects on a consistent basis, and greater ability for WEFO to control quality and facilitate sharing of data with programme evaluations. Seven sustainable tourism projects (known collectively as Environment for Growth or E4G) have commissioned Cardiff University Business School to coordinate the evaluation of all seven projects using a common evaluation framework, but this appears to be the only example of such collaboration.

- 3.108 The ESF Leavers' Survey provides ongoing evidence of the degree of impact achieved by ESF interventions. Some project evaluations, particularly for ESF, have also considered evaluated impacts. However, most evidence on impact at the project level or for particular types of activity is likely to emerge from evaluations in 2014 and 2015 when the programmes are closing and well into the 2014-2020 programming period. It will therefore be difficult to incorporate the findings into the design of the new programmes. A key benefit of the ESF Leavers' Survey is that increasingly robust information on impact is emerging on an ongoing basis and can be used both to manage the programmes and to assess impact over the long term. Such long-term evaluation is particularly important in assessing strategic impacts, such as the impact of Government intervention on innovation in the economy, but most evaluations are commissioned to focus on a particular project over a particular timeframe, normally linked to funding cycles.

Appendices

Appendix 1 - Audit Methods

Appendix 2 - Strategic frameworks

Appendix 3 - Programme level indicator data for ERDF programmes

Appendix 4 - Programme level indicator data for ESF programmes

Appendix 5 - Information required from project sponsors in business plans



Appendix 1

Audit Methods

We used a range of methods to gain evidence for our review.

Literature review

We reviewed a wide range of published reports and other documents, including:

- The operational programmes for each of the four programmes managed by WEFO
- EU regulations governing the use of the Structural Funds
- WEFO's guidance notes for applicants
- Minutes and papers of the all-Wales Programme Monitoring Committee
- Notes and minutes of WEFO's senior management team
- Programme evaluations, in particular:
 - *Effectiveness of Implementation in the 2007-2013 Structural Funds Programming Period*, evaluation commissioned by WEFO, January 2011
 - Databuild Research and Solutions, *WEFO Customer Insight Survey 2009*, WEFO, May 2010
 - WEFO, *Spatial European Teams: an evaluation*, WEFO, November 2010
 - Cardiff University, Old Bell 3 Ltd and IFF Research Ltd, *The 2011 European Social Fund Leavers' Survey*, WEFO, March 2013
 - Old Bell Ltd in association with Cardiff University and IFF Research Ltd, *ERDF Business Survey*, published by WEFO in 2012
- Project evaluations published by WEFO and the Welsh Government, as at 31 May 2013
- Key reports published by other organisations:
 - National Assembly for Wales Finance Committee, *The Effectiveness of Structural Funds in Wales*, December 2012
 - Dr Grahame Guilford, *Investing in Growth and Jobs: an independent review of arrangements for implementation of European Structural Funds programmes 2014-2020*, WEFO, March 2013
- Audit Authority reports, in particular annual control reports and reports on WEFO's systems for appraising project applications, monitoring the progress of projects, paying grant claims and project verification and inspection.

Survey of project sponsors and project development officers

We conducted a survey of all project sponsors and project development officers as at January 2011 to establish their views on the European Structural Funds at that time. The survey used the 'Sensemaker' technique, which asks respondents to describe their experience of a particular issue (in this case, of their involvement with Structural Funds) and then to interpret their experience through a series of questions that cover all aspects of the management of the programmes. Two types of questions were used:

- 'triads', where the respondent indicates their opinion in balancing three conflicting statements; and
- 'polarities', where the respondent chooses a position between two opposing statements.

The survey covered the following areas:

- key principles such as the greater emphasis on competitive procurement and the shift to a smaller number of projects;
- WEFO's management procedures at both pre-approval and post-approval stages;
- WEFO's approach to risk and regulation;
- enabling and hindering factors in bringing a project to fruition; and
- risks to the programmes.

We used a mix of thematic analysis of the narrative answers and quantitative analysis of the specific questions to interpret the results of the survey.

We circulated the survey to 102 project sponsors (project managers) and 42 project development officers. We received 91 responses, an overall response rate of 63 per cent. Three respondents delinked to say whether they were project managers or PDOs. The response rate for the remaining 88 responses was 53 per cent for project sponsors and 78 per cent for project development officers.

Interviews

During the course of our study we interviewed the following WEFO staff:

- the Director and other senior managers of WEFO;
- Head of Finance;
- Head of the Certifying Authority;
- managers in the Research, Monitoring and Evaluation (RME) team, Project Inspection and Verification (PIV) team and Payments team;
- priority controllers, who oversee particular areas of policy within the programmes;
- strategic framework coordinators; and
- Heads of the Spatial/Specialist European Teams (SETs).

We also met:

- the Chair and two other members of the Programme Monitoring Committee; and
- the 'desk officers' (officials) responsible for the Welsh programmes at the European Commission.

Case studies and file review

We assessed the business plan, appraisal procedures, evaluation arrangements and progress to date for a sample of eight projects. We met the project manager and project development officer for each of these projects to discuss their assessment of the project and WEFO's procedures.

We reviewed a sample of 36 projects (including the case studies) to consider progress following approval and the application of WEFO's monitoring and performance management procedures. We examined project claims, progress reports and notes of progress meetings for each of the selected projects.

Data analysis

We analysed the progress of the programmes for key monitoring indicators, comparing reported achievements as at 31 December 2013 against overall programme targets and profiled achievements at that date.

Appendix 2

Strategic frameworks

ERDF

Thematic frameworks:

Framework	Priorities and themes covered
Business finance	Convergence – Priority 2, Theme 2 Competitiveness – Priority 2
Climate change	Convergence – Priority 4, Themes 1 and 2 Competitiveness – Priority 3
Community economic regeneration	Convergence – Priority 5, Theme 2
Enterprise	Convergence – Priority 2, Theme 1 Competitiveness – Priority 2
ICT infrastructure and exploitation	Convergence – Priority 1, Theme 2 Competitiveness – Priority 1
Innovation, R&D and technology	Convergence – Priority 1, Theme 1 Competitiveness – Priority 1
Materials efficiency	Convergence – Priority 4, Theme 2
Sustainable transport	Convergence – Priority 3, Theme 1

Spatial frameworks – sustainable regeneration:

Framework	Priorities and themes covered
Central Wales	Convergence – Priority 3, Theme 2 – Priority 4, Theme 3 – Priority 5, Theme 1 Competitiveness – Priority 4
North Wales	
Pembrokeshire Haven	
South-east Wales	
Swansea Bay	

ESF

Framework	Priorities and themes covered
Improving public services	Convergence – Priority 4
Improving skills levels and adaptability of the workforce	Competitiveness – Priority 2
Increasing employment and tackling economic inactivity	Convergence – Priority 2, Themes 1 and 2 Competitiveness – Priority 1
Promoting gender equality in employment	Convergence – Priority 3, Theme 3
Raising the skills base of the workforce and supporting progression in employment through basic and intermediate level skills	Convergence – Priority 3, Theme 1
Skills for the Knowledge Economy: Higher Level Skills and Systems for Workforce Development	Convergence – Priority 3, Theme 2
Supplying young people with skills and learning for future employment	Convergence – Priority 1
Sustainable transport	Convergence – Priority 3, Theme 1

Source: WEFO

Appendix 3

Programme level indicator data for ERDF programmes

Indicator	Unit of measurement	End of programme			Up to 31 December 2013		
		Forecast (F1)	Target (T)	% (F1/T)	Achieved (A)	Forecast (F2)	% (A/F2)
Convergence							
Enterprises assisted	Number	17,622	14,150	125%	10,666	10,890	98%
Collaborative R&D	Number	1,245	514	242%	974	873	112%
Gross jobs created	No FTE	32,877	33,200	99%	17,011	17,336	98%
Enterprises created	Number	8,707	5,094	171%	4,971	5,100	97%
Profit benefit	£ millions	108	302	36%	10	26	39%
Investment induced	£ millions	277	473	58%	152	137	111%
Jobs accommodated	Number	3,185	1,050	303%	1,582	1,386	114%
Premises created or refurbished	sq metres	136,608	42,500	326%	62,474	79,049	79%
New or improved projects, processes or services launched	Number	2,531	5,028	50%	1,536	1,262	122%
Gross passenger kilometres on public transport	000 km	523,452	400,000	131%	339,583	339,983	100%
Waste reduced, reused or recycled	000 tonnes	406	600	68%	0	100	0%

Indicator	Unit of measurement	End of programme			Up to 31 December 2013		
		Forecast (F1)	Target (T)	% (F1/T)	Achieved (A)	Forecast (F2)	% (A/F2)
Competitiveness							
Enterprises assisted	Number	4,416	1,750	252%	2,037	2,123	96%
Collaborative R&D	Number	44	10	440%	9	15	60%
Gross jobs created	No FTE	10,175	5,340	191%	6,638	6,464	103%
Profit benefit	£ millions	9	30	29%	4	4	105%
Products, processes or services registered	Number	208	80	260%	123	119	103%
New or improved projects, processes or services launched	Number	286	400	72%	135	150	90%
Investment induced	£ millions	88	115	76%	42	38	111%
Enterprises created	Number	3,142	510	616%	2,603	2,530	103%

Source: WEFO programme and project database (PPIMS)

Appendix 4

Programme level indicator data for ESF programmes

Indicator	Unit of measurement	End of programme			Up to 31 December 2013		
		Forecast (F1)	Target (T)	% (F1/T)	Achieved (A)	Forecast (F2)	% (A/F2)
Convergence							
Total participants	Number	536,256	267,500	200%	423,430	443,028	96%
Female participants	Number	258,000	146,150	177%	0	n/a	n/a
Economically inactive participants	Number	161,000	63,750	253%	108,225	n/a	n/a
Unemployed participants	Number	93,000	55,000	169%	104,995	n/a	n/a
Employed participants	Number	168,000	122,500	137%	113,122	n/a	n/a
Employers assisted or financially supported	Number	22,043	20,060	110%	11,678	12,615	93%
Collaborative agreements between public service bodies	Number	115	20	575%	24	38	63%
Participants entering employment	Number	72,333	27,500	263%	46,012	55,321	83%
Participants gaining qualifications	Number	203,655	79,530	256%	139,993	143,153	98%
Participants gaining a basic skills qualification	Number	83,700	43,900	191%	53,201	n/a	n/a
Participants gaining a qualification at Level 2	Number	75,400	23,000	328%	63,120	n/a	n/a
Participants gaining a qualification at Level 3	Number	28,400	8,900	319%	17,532	n/a	n/a
Participants gaining a qualification at Level 4 and above	Number	16,200	3,800	426%	6,140	n/a	n/a
Participants entering further learning	Number	61,321	57,700	106%	36,128	45,422	80%

Indicator	Unit of measurement	End of programme			Up to 31 December 2013		
		Forecast (F1)	Target (T)	% (F1/T)	Achieved (A)	Forecast (F2)	% (A/F2)
Competitiveness							
Total participants	Number	92,971	26,600	350%	64,112	76,247	84%
Female participants	Number	41,000	15,190	270%	27,264	n/a	n/a
Economically inactive participants	Number	35,500	11,900	298%	21,969	n/a	n/a
Unemployed participants	Number	15,100	2,100	719%	14,105	n/a	n/a
Employed participants	Number	42,500	12,600	337%	28,010	n/a	n/a
Employers assisted	Number	7,062	2,800	252%	3,381	4,284	79%
Participants entering employment	Number	16,021	3,500	458%	7,769	12,020	65%
Participants gaining qualifications	Number	31,741	9,650	329%	20,854	22,719	92%
Participants gaining a basic skills qualification	Number	14,900	5,740	260%	4,870	n/a	n/a
Participants gaining a qualification at Level 2	Number	11,300	2,570	440%	9,957	n/a	n/a
Participants gaining a qualification at Level 3	Number	4,200	800	525%	4,674	n/a	n/a
Participants gaining a qualification at Level 4 and above	Number	1,300	540	241%	1,353	n/a	n/a
Participants entering further learning	Number	5,757	4,620	125%	1,324	3,821	35%

Source: WEFO programme and project database (PPIMS)

Appendix 5

Information required from project sponsors in business plans

Sponsors submit business plans with information under the following headings:

- 1 Project description
Aims, objectives, contribution to Government policy, activities, beneficiaries, location
- 2 Project management and delivery
Record of project management, organisation of the project, resources available, procurement
- 3 Need and demand for the project
Research that identifies need and quantifies demand, feasibility studies, details and justification of any duplication or displacement of existing activity
- 4 Options for delivery
Analysis of options for delivering the project, including the 'do nothing' option
- 5 Outputs and results
- 6 Financial profile
Detailed breakdown of costs and cash flows with any assumptions used
- 7 Financial package
Explanation of match funding sources and justification for level of funding sought
- 8 Value for money
Evidence to support the case for economy (cost of inputs), efficiency (relationship between costs and outputs), effectiveness (how the outputs and results will create the impacts required)
- 9 Added value
How the project will create new benefits and support activity that would otherwise not take place or be reduced/postponed
- 10 Monitoring and evaluation
Selection of indicators, how data will be collected, data quality, evaluation timing and methods
- 11 Post funding/continuation strategy
Exit strategy and project legacy
- 12 Risk management
Approach to management of key risks
- 13 Publicity
Public acknowledgement of EU funding, publicity activities, dissemination of good practice

By virtue of paragraph(s) ix of Standing Order 17.42

Document is Restricted

Senior Staff Pay

Universities in Wales



Noddir gan
Lywodraeth Cymru
Sponsored by
Welsh Government

Senior Staff Pay – Universities in Wales

About HEFCW

1. HEFCW is responsible for funding higher education (HE) in Wales. We distribute funds for education, research and related activities at higher education institutions, including the teaching activities of the Open University in Wales. We also fund higher education courses at further education colleges. As a Welsh Government Sponsored Body, we receive our funds from, and are accountable to, the Welsh Government.

Purpose

2. This submission provides a response to the request for HEFCW to provide evidence to inform the Committee's inquiry into senior management pay across the Welsh public sectors. We have not had the opportunity to seek approval of HEFCW's Council for this submission which must therefore be regarded as a submission from HEFCW executive only.

Responsibility for senior staff pay

3. Universities are not public sector organisations. They are autonomous bodies established by either Royal Charter or as Higher Education Corporations under the terms of the 1992 Further and Higher Education Act (the '1992 Act'). HEFCW has no powers under the terms of the 1992 Act to influence University employment terms and conditions, including the levels of senior staff salaries.
4. As autonomous bodies, the setting of senior staff salaries falls under the responsibilities of each University's Governing Body. The Committee of University Chairs (CUC) publishes a 'Guide for Members of Higher Education Governing Bodies in the UK'¹, which covers staff remuneration amongst other matters. This CUC document notes that '*The governing body has responsibility for the institution's human resource and employment policy. This includes ensuring that pay and conditions of employment are properly determined and implemented for all categories of employee. The governing body is also responsible for appointing and setting the terms and conditions for the head of the institution and such other senior posts as it may from time to time determine*'.

The mechanism by which senior staff salaries are set

5. In respect of the mechanism by which Universities set senior staff salaries, the CUC Guide states that '*Governing bodies should establish a remuneration committee to determine and review the salaries, terms and conditions (and, where appropriate, severance payments) of the head of institution and such other members of staff as the governing body deems appropriate*'. The CUC and Leadership Foundation for Higher Education

¹ www.hefce.ac.uk/media/hefce1/pubs/hefce/2009/0914/09_14.pdf

(LFHE) also publish a guide on 'Getting to Grips with Human Resource Management'² which provides more detailed guidance for University Governing Body members on HR matters including Senior Staff remuneration. This provides guidance on the composition and role of University Remuneration Committees.

6. In response to a request by HEFCW, all Universities in Wales have recently provided brief information on their arrangements for setting senior staff salaries, including confirmation of the use of a Remuneration Committee. Further detail on the arrangements by which individual Universities in Wales set their senior staff salaries are attached at **Annex A**. In general, senior staff roles are subject to role analysis (e.g. Higher Education Role Analysis - HERA), with market rates used to inform starting salaries. The Universities and Colleges Employers Association (UCEA) has also published information on effective practice in setting senior staff pay and grading structures in higher education³. Drawing on such information, the Remuneration Committee oversees the agreement and review of these senior staff salaries.
7. HEFCW's Assurance Service undertook a 'Review of the Remuneration and Severance Governance Processes for Senior Staff at Higher Education Institutions in Wales'⁴ in 2005. The overall opinion of this review was that governance processes, in relation to senior staff salaries and severance, were broadly sound across the sector.

Transparency

8. Universities publish information on senior staff salaries in their annual financial statements. The published HEFCW 'Accounts Direction to Higher Education Institutions' informs institutions of HEFCW's requirements relating to their annual financial statements and in particular the disclosure of remuneration and severance payments for higher paid employees (including the head of institution). Under the most recent Accounts Direction⁵, Universities were required to disclose the following:
 - The actual total remuneration of the head of institution including bonuses (but not details of bonuses earned).
 - The remuneration of higher paid staff in bands of £10,000 from a starting point of £100,000. External payments were to be included. Disclosure was also required for those staff who joined part way through a year but who would have received remuneration in these bands in a full year.

²www.lfhe.ac.uk/filemanager/root/site_assets/research_resources/g2g/G2G%20HR%20Management.pdf

³www.ucea.ac.uk/en/empres/paynegs/randr/sen-pay/

⁴[www.hefcw.ac.uk/documents/working_with_he_providers/institutional_assurance/review%20of%20remuneration%20and%20severance%20governance%20processes%20heis%20\(2005\).pdf](http://www.hefcw.ac.uk/documents/working_with_he_providers/institutional_assurance/review%20of%20remuneration%20and%20severance%20governance%20processes%20heis%20(2005).pdf)

⁵www.hefcw.ac.uk/documents/publications/circulars/circulars_2013/W13%2016HE%20Accounts%20Direction%20to%20Higher%20Education%20Institutions%20for%202012-13.pdf

- Details of any compensation paid or payable to the head of institution or staff whose annual remuneration exceeds £100,000.

Senior staff salaries at Universities in Wales

9. Detail on senior staff salaries has been provided by universities in Wales to HEFCW, in order to inform the Committee's inquiry. This is attached at **Annex A**. For the purposes of this submission, each individual institution has used its own definition of the 'senior staff' based on the make-up of its Senior Management Team. The information may differ from that reported in Annual Financial Statements as some Senior Management Team members may receive salaries below the £100,000 reporting threshold and some of the information is more recent than the 2012/13 published accounts. Additionally, the figures reported in Annual Financial Statements may in some instances include higher paid employees that are not Senior Management Team members. Please note that the institutional information has been collated in the form provided to us and may hence vary slightly in format.
10. A recent Times Higher Education (THE) pay survey based on 2012/13 data identified the average UK university Vice-Chancellor/Chief Executive salary as £226,789. By comparison, the Vice-Chancellor's salary (excluding benefits) for five Welsh universities was below the UK average, with only two slightly above the average⁶. When pension contributions and other benefits are factored in, the average total package for UK Vice-Chancellors/Chief Executives was £254,692. Based on the THE Survey, all Welsh Vice-Chancellors received a total package that was slightly below the UK average⁷.
11. Universities in Wales operate in a UK and international marketplace (e.g. in respect of student recruitment and research), with UK and international league tables now widely published. Welsh Universities contribute £3.6 billion to the Welsh economy annually, generating 3% of all Welsh GDP, and earning over £400 million in export earnings through overseas revenue and international students⁸. Consequently the pay of University Vice-Chancellors, and other senior staff, in Wales needs to be broadly comparable with that for other UK universities, if Welsh institutions are to be able to attract talented individuals to these key roles. The published information would seem to indicate that salaries in Wales are broadly comparable.

⁶ The Vice-Chancellor's salary for the University of Wales Trinity Saint David was not included in the Times Higher Education survey though information is provided in Annex A.

⁷ www.timeshighereducation.co.uk/features/times-higher-educations-annual-pay-survey/2012381.article

⁸ www.hew.ac.uk/wp/media/2013-June-The-Economic-Impact-of-Higher-Education-in-Wales1.pdf

University Senior Staff Pay Arrangements by Institution

Aberystwyth University

Senior staff pay arrangements

Senior staff pay arrangements are handled by the University's Remuneration Committee. Each role is subject to a role analysis exercise (HERA is used here in Aberystwyth). For senior posts, market rates are also used to determine starting salaries. The University has recently introduced a Grade 10 band (incorporating the professorial pay band). Progression through this grade is subject to the approval of an internal board.

Remuneration Committee

The University operates a Remuneration Committee, which is chaired by the Chair of the Governing Body

Senior staff salary data

Senior staff salary data for the 2012/13 year, broken down by £10K salary bands, for staff earning £100K or above, is shown below:

<i>Salary range</i>	<i>Number of posts</i>
£110,000 - £119,000	1
£120,000 - £129,999	2
£130,000 - £139,999	1
£140,000 - £149,999	1
£250,000 - £259,999	1

Source: Audited financial statements 2012/13

Senior staff pay arrangements

'Senior staff' are defined in this paper as those serving on the University Executive, which is the approved senior management team for the University. At Bangor, the Executive is slightly larger and more inclusive than in some universities, and it totals 22 senior members of staff. Apart from two, they are all on grade 10 (professorial or professorial-equivalent), the salary level for this grade beginning at £57,031.

The University is currently reviewing salary bands for senior staff, but at the present time staff on grade 10 are not on a fixed pay scale and do not receive an increment or automatic annual pay increase. The University does, however, operate an annual 'Senior Staff Salary Review', which allows senior staff to apply to have their salary reviewed. There are published criteria for staff salary increases, and any application for a salary review is considered by the University's Remuneration Committee. The governing body of the University has agreed rigorous criteria (which are published) for salary increases, and the Committee assesses to what extent an applicant meets the criteria.

Importantly, the Committee has access to the outcomes of an annual survey of salaries of senior university staff across the UK (produced by UCEA), which allows the Committee to benchmark. This valuable data, for example, typically indicates the average and median salaries of staff across the UK in senior posts, and these can be broken down into salary information for pre-1992 and post-1992 institutions, institutions in different regions, and institutions of various sizes.

In 2013/14, the University has decided on financial grounds not to operate a Senior Staff Salary Review, and therefore no senior member of staff will receive any pay increase this year (apart from the 1% annual inflation increase agreed nationally for all staff).

With regard to starting salaries, the University appoints the best candidate for any given post, and the starting salary is determined with reference to the circumstances of the post. Normal market conditions will usually apply. When existing staff are promoted internally to the senior grade, it is the policy of the University to ensure that they receive a reasonable uplift in salary of £3,000.

Remuneration Committee

The Remuneration Committee is a standing committee of the governing body of the University (the Council), and its membership includes 4 senior lay members of the governing body, including the Chair of the governing body who Chairs the Remuneration Committee. The Remuneration Committee has delegated powers to agree salary levels for senior staff.

Senior staff salary data

The numbers of senior staff in the various salary bands are:

<i>Salary range</i>	<i>Number of posts</i>
60 - 64K	2
65 - 69K	3
75 - 79K	3
80 - 84K	2
85 - 89K	1
90 - 94K	3
95 - 99K	1
100 - 104K	1
105 - 109K	1
110 - 114K	1
120 - 124K	1
135 - 139K	1
150 - 154K	1
155K +	1

Total 22.

Senior staff pay arrangements

All Senior Staff Pay in Cardiff University is managed on a strategic basis by the University Remuneration Committee, and enacted by the University following core principles set down by this committee. The University publishes its Senior Staff Pay Policy on annual basis. There is a systematic and transparent process for consideration of the salary of any member of the senior staff.

Senior staff are appointed to a spot salary based on consideration of three elements: role responsibilities, market worth and relevant internal pay differentials. Pay is proportionate to the responsibilities of senior staff roles within a Russell Group University of around 6,000 staff, more than 28,000 students and an annual turnover of more than £400 million.

It is essential that the University is able to compete with other world-leading universities both in the UK and overseas, salaries at Cardiff University are therefore consistent with its standing as Wales' only member of the Russell Group of leading UK research Universities, which attracts a geographically diverse range of students; collaborates with worldwide institutions, governments and businesses; and conducts research that is proven to have global significance and impact. In doing so the University contributes significantly to Wales in terms of the economy, social equality and international profile.

The same principles apply in determining starting salaries for internal appointments/promotions as well as for external recruits. In common with other chartered Universities, a number of senior offices are held on a rotational basis for a fixed period of 3 or 5 years. Undertaking such Senior Management responsibilities attracts a standard non-pensionable Senior Management Allowance while holding the role. This allowance is temporary and is removed when the individual stands down from the Senior Management role.

The Remuneration Committee considers annually whether there should be a review of senior staff pay and if so how extensive that review should be. Remuneration for the University Executive Board is determined by the Remuneration Committee; other Senior Staff remuneration is based on recommendations by University Executive Board members on their respective areas of responsibility, and approved by the Remuneration Committee. Decisions are based on the performance and achievements of the Senior Staff over the year, and supported by comprehensive management information.

In exceptional circumstances only, the University may review pay for individual job-holders during the course of the year. The Remuneration Committee delegates to the Chair of the Remuneration Committee and/or the

Vice-Chancellor the ability to make decisions on such out-of-cycle reviews. All such awards are reported to the Committee's next meeting.

Remuneration Committee

As highlighted the University operates a Remuneration Committee which is made up of the following members:

Chair: Chair of Council: Mr John Jeans
 Vice-Chair of Council: Dr G Treharne
 Two lay Council Representatives appointed by Council, Mrs G Williams and Mrs P Herbert
 Vice-Chancellor: Professor C Riordan
 Deputy Vice-Chancellor: Professor E Treasure

Biography details are available on the University Web should you wish further information on its members (www.cardiff.ac.uk/govrn/governance/index.html)

The Committee operates a strict protocol which requires individuals to leave the meeting should their salary be discussed. In the case of the setting of the Vice-Chancellor, the Vice-Chair of Council chairs the meeting, with the Chair of Council reporting on performance of the Vice-Chancellor against his written objectives and of the University against its strategic objectives.

Senior staff salary data

Senior Management* Base Salary in 5k Bands	
Band	Number of Staff
£65000 - £69999	1
£70000 - £74999	3
£75000 - £79999	7
£80000 - £84999	3
£85000 - £89999	6
£90000 - £94999	8
£95000 - £99999	3
£100000 - £104999	2
£105000 - £109999	2
£110000 - £114999	3
£115000 - £119999	2
£120000 - £124999	2
£125000 - £129999	4
£130000 - £134999	3
£140000 - £144999	1
£145000 - £149999	1
£150000 - £154999	1
£235000 - £239999	1

* Senior Management includes UEB, Heads of School, Deans and Senior Management in Professional Services

Senior staff pay arrangements

It is understood that the information provided in this note is required for an inquiry being undertaken by the Public Accounts Committee of the National Assembly for Wales into senior management pay across the Welsh public sector.

For the purposes of this request the term 'senior staff' has been interpreted as members of staff formally designated by the Board of Governors as senior post-holders in accordance with the University's Articles of Government, as approved by the Privy Council, and thus falling within the remit of the Remuneration Committee for matters relating to salary and conditions of service.

In setting and reviewing salaries the Remuneration Committee takes independent advice from the Hay Group and takes account of comparative pay data produced by the Universities and Colleges Employers Association (UCEA), Universities UK (UUK) for the Vice-Chancellor, and any other relevant source.

.1 Starting Pay

Whenever a new senior post is established or a vacancy for such a post occurs, the post is advertised nationally and assessed by the Hay Group for matters of job size and responsibility to permit an accurate identification of appropriate salary. The starting salary will be the outcome of negotiations with the successful applicant, taking account of the Hay Score, Hay Group and sector comparative pay data, experience and any other relevant factor.

.2 Salary Review

Salary and terms of conditions for all senior posts are reviewed annually but it does not follow that salaries are increased annually. Any increase takes account of the market, the University's financial position and the individual's performance against agreed criteria and objectives; there is currently no provision for performance-related pay. In reviewing salaries the Remuneration Committee will have regard to base salary levels for jobs of similar size in the Industrial and Service sector throughout the UK, as shown in Hay Group surveys, and comparative UCEA and UUK data as appropriate. Such review will also take account of recent pay developments in the higher education sector, the need to maintain appropriate relativities with the rest of the University's pay structure, and trends in prices and earnings in the wider economy.

Remuneration Committee

As stated above, authority to determine salary and terms and conditions for designated senior post holders is delegated to the Remuneration Committee

subject to a requirement to report determinations to independent governors at the next following meeting of the Board of Governors and to the presentation of an open report summarising business annually. The Remuneration Committee is comprised of five independent governors and the Vice-Chancellor (who is not a member for any item dealing with his own salary and terms and conditions).

Until 31 July 2013 the Remuneration Committee was chaired by the Chair of the Board of Governors. Since 1 August 2013 the Remuneration Committee has been chaired by the Vice-Chair of the Board of Governors, the Chair of the Board of Governors remaining as a member of the Committee. The current Chair of the Remuneration Committee is Mr. Peter Williams CBE, former Chief Executive of the Quality Assurance Agency.

Neither the Vice-Chancellor nor the Secretary & Clerk to the Governors, who acts as Secretary to the Remuneration Committee, is present when the Committee determines matters relating to his salary or terms and conditions.

Senior staff salary data

Following organisational review, a new, smaller Level 2 structure came into effect on 1 August 2013. Including the Vice-Chancellor and the Secretary & Clerk, senior post holders from 1 August 2013 number eight including two fractional posts, giving seven full-time equivalent posts.

Current salary data are provided as requested in £10k salary bands:

<i>Salary range</i>	<i>Number of posts</i>
£75,000 - £80,000	1
£100,000 - £115,000	2 (1 at FTE 0.5)
£115,001 - £120,000	2 (1 at FTE 0.5)
£120,001 - £125,000	1
£125,001 - £130,000	1
£190,000 - £195,000	1

The University has six staff, including the Vice Chancellor, who are classed as 'holders of senior posts' [senior post-holders] as defined in the Instrument and Articles. The appointment, grading, suspension, dismissal and determination of the pay and conditions of service of the holders of senior posts are the responsibility of the Board of Governors.

The Board of Governors delegates responsibility for the determination of pay and conditions to the Human Resources Committee, meeting as the Remuneration Committee at least annually.

The Board has approved the following policies and procedures in respect of senior post-holders:

- *Procedure for determining the remuneration, contract and conditions of service of roles that will be held by senior post-holders*
- *Remuneration policy and procedure for senior post-holders.*

Senior staff pay arrangements

A. Starting Pay:

Vacancies relating to existing posts:

i. Where a senior post-holder vacancy arises in respect of an existing senior post-holder role, and the Vice Chancellor and Chief Executive determines that there needs to be no substantial change to the approved senior post-holder role description, contractual arrangements or salary range, the Vice Chancellor is authorised to arrange recruitment in accordance with the University's recruitment and selection policy. The Chairman of the Board and the Chair of the HR Committee shall be notified by letter that arrangements have been made for information purposes.

ii. Where a senior post-holder vacancy arises, and the Vice Chancellor and Chief Executive determines that there is a need to amend the approved Senior Post-holder role description, contractual arrangements or salary range, he/she will take steps to discuss the proposed changes with the Chair of HR Committee and the Chairman of the Board. A formal note of the discussion shall be kept and agreed by all parties. The agreed role description, contractual arrangements and salary range will be provided to the Human Resources Department by the Vice-Chancellor's Office, to allow for recruitment to take place in line with the University's recruitment and selection policy;

iii. In circumstances where the interview panel wishes to make changes to an agreed role description, contractual arrangements or salary range, the Vice Chancellor and Chief Executive shall discuss the matter with the Chair of HR Committee and the Chairman of the Board. As a guide, considerations may include the prospective candidate's current remuneration package, contract and conditions of services; market rates for remuneration of the post in

question; budgetary considerations; and comparison with contracts and conditions of similar senior post-holders within Glyndŵr University. A formal note is kept of the discussions and the agreed outcome.

iv. The final details of all remuneration packages, contracts and conditions of service, (where the latter varies from the “standard” senior post-holder contract/conditions of service) once accepted by the senior post-holder, shall be reported to the HR Committee as a Chair’s action at the next scheduled meeting, as a confidential item.

Filling vacancies relating to new posts:

- i. Where the Vice Chancellor and Chief Executive determines that a new Senior post-holder position is required in line with the University’s needs at a particular time, discussion will take place between the Vice Chancellor and Chief Executive, the Chair of HR Committee and the Chairman of the Board to discuss an appropriate role description, contractual arrangements and salary range. A formal note of discussions shall be kept and an agreed role description will be provided to the Human Resources Department by Vice Chancellor’s Office, to allow for recruitment to take place in line with the University’s recruitment and selection policy.
- ii. In circumstances where the interview panel wishes to make changes to an agreed role description, contractual arrangements or salary range, the Vice Chancellor and Chief Executive shall discuss the matter with the Chair of HR Committee and the Chairman of the Board. As a guide, considerations may include the prospective candidate’s current remuneration package, contract and conditions of service; market rates for remuneration of the post in questions; budgetary considerations; an comparison with contracts and conditions of similar senior post-holders within Glyndŵr University. A formal note is kept of the discussions and the agreed outcome.
- iii. The final details of all remuneration packages, contracts and conditions of service, (where the latter varies from the “standard” senior post-holder contract/conditions of service) once accepted by the senior post-holder, shall be reported to the HR Committee as a Chair’s action at the next scheduled meeting, as a confidential item.

B. Pay Increases

The Human Resources Committee meets at least annually as the Remuneration Committee to review the remuneration of senior post-holders. A remuneration policy and a procedure are in place.

The Board of Governors has agreed that the HR Committee, following the approved procedural guidance, shall make decisions regarding the remuneration of Senior Post-holders.

Specifically, the Board of Governors has determined that in reaching its decisions on the remuneration of Senior Post-holders the HR Committee must, as a minimum, be able to demonstrate due regard to the following factors:

- Consideration of performance review data for every Senior Post-holder presented by the Vice Chancellor for all Senior Post-holders with the exception that the Chair of the Board of Governors shall present the report relating to the Vice Chancellor and Chief Executive.
- In considering such data the HR Committee shall, in accordance with national pay modernisation principles for HEIs in the UK, have due regard to the contribution and value to the University that is evidenced by the report on the performance of each Senior Post-holder and
 - Consideration of any changes in responsibilities.
 - Consideration of comparative data including UCEA data, remuneration trend analyses at local and national levels, relevant market data, relevant and recent published data on senior salaries at other UK HEIs, and such other relevant publicly available data as the HR Committee may determine. The HR Committee may also seek independent advice as it deems appropriate.
 - Consideration of affordability including the available pay budget, and relevant recruitment and retention factors.
 - Consideration of employee relations including wider perceptions of pay awards to Senior Post-holders, and possible impacts on staff morale and motivation.
 - Consideration of succession planning and Glyndŵr University's Human Resources Strategy.
 - Consideration shall be given to remuneration increases where they are put forward by the Vice Chancellor (in the case of Senior Post-holders) and in the case of the Vice Chancellor and Chief Executive, by the Chair of the Board of Governors. Careful consideration should be given to the recommendations made by the Vice Chancellor and Chief Executive and wherever the Committee agrees to make a change to a Senior Post-holder's Remuneration that is not supported by the Vice Chancellor and Chief Executive, the report of the meeting shall make explicit reference to the reasons for the Committee's decision.
 - Consideration may be given to a decrease in remuneration for any individual depending on the above factors.
 - Consideration may be given to proposals relating to job re-design as an alternative to changes to an individual's remuneration.

In its procedure the Board sets out the requirements of the Remuneration Committee meeting in order to inform its review of remuneration. The Committee requires comparative data in a formal background paper which

must be circulated in advance with the agenda papers and presented by the Clerk at Remuneration Committee meetings.

Details of salaries (where available) for senior post-holders, including the Vice Chancellor and Chief Executive, in similar posts at cognate HEIs, specified as a minimum benchmarking group.

Where these institutions have not recently advertised for senior post-holders, any additional data on recent advertisements for senior posts in other comparable UK HEIs. This paper may also where appropriate, provide information on salaries in cognate posts in other sectors including public sector organisations.

UCEA data relating to all Glyndŵr University's Senior Post-holders presented in visual form benchmarking against UCEA quartiles and deciles as appropriate drawing on previous periods. This data shall be provided by the Director of Finance working with the Human Resources team and updated each year.

Details of historical remuneration trends within Glyndŵr University including a record of decisions made at the previous two salary reviews in each case.

The Remuneration Committee is required to present a report of its deliberations and the outcomes to the next meeting of the Board of Governors as a reserved item.

Remuneration Committee

The University operates a Remuneration Committee and its role is as explained above in response 1.

The Committee is made up of four independent member of the Board of Governors, one of whom is the Chair of the Committee. The Vice Chancellor is also a member of the Committee, but withdraws during discussion of his own remuneration. The Chairman of the Board must also be present when remuneration of Senior Post-holders is being discussed, which is in line with CUC Guidance.

Senior staff salary data

<i>Salary range</i>		<i>Number of posts</i>
£75,000	- £80,000	2
£85,000	- £ 90,000	2
£100,000	- £105,000	1
£ 200,000	- £205,000	1

Within the senior staff numbers given below we have a number of senior clinical academic staff. These are paid in accordance with national rates agreed for NHS consultants and the following comments do not apply to them.

Senior staff pay arrangements

Starting salaries of senior staff are based on a number of considerations including job size, relating to the responsibility level of the post, skills, experience and (if academic) their academic profile and achievements, market factors including internal comparators.

Salary decisions on appointment are normally made by the Vice- Chancellor in conjunction with advice from senior officers including the Director of Human Resources, Registrar and Chief Operating Officer. In some cases, the Chair of Council is consulted.

Pay increases are awarded through two mechanisms:

- Senior staff are invited, and expected, to make a submission for a salary award based on their performance in their role over the past year. Decisions on whether to award a salary increase, and the level of any such award to be made in each individual case are made by the University's Remuneration Committee.
- In addition the University normally applies the nationally negotiated pay award as recommended by UCEA to senior staff.

Remuneration Committee

The University operates a Remuneration Committee, which reviews senior staff salaries on an annual basis. The Committee is chaired by the Chair of Council.

Senior staff salary data

Remuneration of higher paid staff, excluding employer's pension contributions but including payments made on behalf of the NHS in respect of its contractual obligations to University staff under separate NHS contracts of employment and which are reimbursed to the University by the NHS, was:

<i>Salary range</i>	<i>Number of posts</i>	
	<i>2013</i>	<i>2012</i>
£100,000 – £109,999	7	6
£110,000 – £119,999	4	6
£120,000 – £129,999	4	1
£130,000 – £139,999	4	2
£140,000 – £149,999	2	3
£150,000 – £159,999	3	2
£160,000 – £169,999	1	3
£170,000 – £179,999	1	0

£180,000 – £189,999	0	1
£190,000 – £199,999	0	0
£200,000 – £209,999	0	0
£210,000 – £219,999	0	1
£220,000 – £229,999	0	0
£230,000 – £239,999	1	0

The University of South Wales received a request on 17th January 2014 for information about its processes in regard to senior management pay. Specifically the University has been asked to respond to the following requests:

1. An explanation of how senior staff pay arrangements are managed within the University, both in terms of starting pay and pay increases. This should include an explanation of how salary decisions are reached for these staff.
2. Information on whether the University operates a Remuneration Committee (or equivalent) to handle senior staff pay issues, including details of the Committee Chair.
3. Senior staff salary data in the form of numbers of senior staff broken down by £10k salary bands (please do not provide the names of individuals).

The University's formal response is set out below:

Senior staff pay arrangements

In 2008 the University of Glamorgan implemented the National Framework Agreement, a sector wide agreement with the national Trade Unions relating to pay and grading and terms and conditions of employment. On implementation, the University of Glamorgan introduced a locally agreed pay and grading structure developed after an extensive process of role analysis and a 'best fit' assessment of existing posts. This pay and grading structure included all posts within the University of Glamorgan, up to and including the Vice Chancellor.

In 2013, after merger with the University of Wales, Newport local agreement was reached with the recognised Trade Unions for the University of South Wales to adopt the University of Glamorgan's pay and grading structure and associated terms and conditions of employment. The basic tenet of all posts, including senior posts, having a grade comprising between 1 and 6 spinal points continues unchanged. The pay and grading structure for the University of South Wales is attached at Appendix One.

On approval of a new post, the grade is established using the HERA role analysis system. Advertised vacancies include detail of the pay and grading structure and the statement that the University's normal practice is for new starters to commence at the minimum salary for the grade.

In the case of senior management posts, grades are likely to comprise only one spinal point and therefore do not allow for annual incremental progression.

The nationally negotiated annual cost of living pay award is paid to all staff, including senior staff subject to the prior approval of the Board of Governors. The University of South Wales does not operate a performance-related pay system or any form of bonus payment system for senior staff.

Employees of the University, including senior staff are eligible to be members of a pension scheme. All senior staff are members of the Local Government Pension Scheme, Teachers Pension Scheme or Universities Superannuation Scheme, depending on the nature of their post. The Regulators of all three pension schemes establish the level of Employer's contribution required, which the University of South Wales is liable to pay. No additional payments are made to pension schemes by the University on behalf of senior staff. The University of South Wales' Board of Governors has agreed that no additional salary payments will be made to senior staff that opt to leave a pension scheme due to reaching the Lifetime Allowance.

Remuneration Committee

The University of South Wales has, as a sub-committee of the Board of Governors, a Remuneration Committee. Its composition is:

Chair of the Board (ex officio)

Deputy Chair of the Board (ex officio)

Chair of the Human Resources Committee (ex officio)

Chair of the Finance and Resources Committee (ex officio)

One other Governor (other than Staff Student Governors)

Vice-Chancellor (except in respect of his/her own remuneration)

Its current Chair is: Mr Haydn Warman (Deputy Chair of Board ex officio). He is a retired executive director of Principality Building Society; formerly General Manager Norwich and Peterborough Building Society. Having qualified as a solicitor he spent several years in private practice and subsequently within the Legal Division of the Welsh Office. A non-executive member of the Audit and Risk Management Committee of the Wales Audit Office and a non-executive Director of the Monmouthshire Building Society and Monmouthshire Insurance Services Limited. He lives in the Vale of Glamorgan.

The Committee's terms of reference are:

- 1) to review the remuneration (grade and contribution pay) of the Executive and Vice-Chancellor, in accordance with the Framework set by the Board on the recommendation of the Human Resources Committee, and make recommendations to the Board using sector and institution wide data as necessary and appropriate;
- 2) to receive, not less than annually, a report from the Vice-Chancellor on the remuneration of Deans, corporate Heads of Department and equivalent level three posts reporting to Executive members, as recommended by the Executive in accordance with the Framework, and approve the Executive's recommendations;
- 3) to make recommendations to the Board on severance payments to the Vice-Chancellor and approve severance payments to members of the Executive and such other senior staff, as determined from time to time by the Board of Governors.

Senior staff salary data

Salary Band £		Grade	Job Title
105,001 110,000	–	O	Pro Vice Chancellor
115,001 120,000	–	O/P	Deputy Vice Chancellor (x3 posts)
125,001 130,000	–	P	College Principal
190,001 195,000	–	Q	Vice Chancellor

Senior staff salary arrangements

The appointment of senior officers - Vice Chancellor and Pro Vice Chancellors - are made by the University Council. In determining the level of salary the University utilises the UCEA Pay Survey. This Survey is also used for the annual review of Senior Salaries.

Remuneration Committee

A Senior Remuneration Committee meets at least once a year to review the salaries for the individuals appointed to the roles of Vice Chancellor and Pro Vice Chancellor. The current chair of the Senior Remuneration Committee is the Venerable Randolph Thomas who is one of the Co-Vice Chairmen of the University of Wales Trinity Saint David. The Senior Remuneration Committee includes an external member who has no involvement in any other facet of the University's functioning. The current external member has considerable knowledge of HE remuneration schemes.

When utilising the UCEA Pay Survey the Senior Remuneration Committee uses the figures relating to institutions of similar size and structure. Reference is also made to other Senior salary payment reviews which are made available for perusal by the panel. This may include non HEI reviews. The Senior Remuneration Committee carefully consider the use of independent advice and of its appropriateness to the institution.

The terms of reference of the Senior Remuneration Committee are reviewed annually so as to meet the changing circumstances and needs of the institution. The Senior Remuneration Committee submit an annual report to the University Council on its activity.

The Senior Remuneration Committee also has responsibility for appointing the Clerk of the University Council when this appointment is not an internal appointment. The salary for a non-internal appointment is reviewed annually at the meeting of the Senior Remuneration Committee.

Three University's policies direct the processes employed - 'Procedures for the Remuneration of Senior Staff', 'Severance Policy for Senior Staff', and Senior Management Succession Strategy'.

Senior staff salary data

Please see below information in relation to senior officer salaries:

<i>Salary range.</i>	<i>Number of posts</i>
£200K to £205K	1
£165K to 170K	1
£125K to £130K	2
£90K to £95K	3

The figures are for salary only and do not included employments costs.

One of the people in the lowest band is a 0.5, so has been included at the full time equivalent.

Welsh Assembly Public Accounts Committee inquiry into senior management pay: Committee of University Chairs briefing note.

Introduction

The Committee of University Chairs (CUC) welcomes the opportunity to provide a briefing note Welsh Assembly Public Accounts Committee inquiry into senior management pay on the remuneration practices in higher education.

The CUC is the representative body for Chairs of UK Higher Education Institution (HEI) governing bodies and being a UK-wide body, works closely with the Chairs of Higher Education in Wales (CHEW). The CUC's main purpose is to enable the chairs of governing bodies to contribute their distinctive experience, knowledge and perspective as laypersons to the benefit of the governance of the sector as a whole, articulated through the voluntary Governance Code of Practice (the Code) and other Guidance. The Code provides governing bodies with an authoritative source of advice and guidance on their responsibilities and behaviours, practices and standards that are expected to be maintained, this includes in the area of the recruitment and remuneration of senior staff.

Although the Code is voluntary the funding councils in both Wales and England¹ view adoption of the principles of the code adapted as appropriate to each HEI's character, as an important factor in enabling them to rely on self-regulation within HEIs. The extent to which institutions adopt the code is noted within their annual reports.

The higher education remuneration process

UK HEIs, including those in Wales, are successful, complex and diverse organisations operating in an increasingly competitive global environment. The autonomy to develop, within recognised practice and standards, individual approaches to governance reflecting institutional context is critical to both the success of HEIs and the sector as a whole. This includes individual institutions setting their own remuneration policies.

Governing Bodies are very much aware of their responsibilities in this area and of the importance of giving confidence to all stakeholders that they have a mature and balanced approach towards senior remuneration. Staff costs are the biggest item of expenditure in any institution and Governing Bodies understand that accountability expectations make it all the more important for decisions on pay at all levels to be based on sound and robust principles.

Within HEIs senior levels of pay are determined by independent remuneration committees which report to their university's governing body. Remuneration committees are accountable to the governing bodies they advise and it is the governing body which is collectively accountable for institutional activities, taking all final decisions on matters of fundamental concern.

CUC's guidance² states that it is for individual remuneration committees to determine and review the employment terms and conditions of senior staff, including approaches to pay and reward. Each university is autonomous in this respect and decisions on remuneration will reflect their

¹ Scottish Institutions are required by the devolved administration to reference an alternative code.

² See appendix

individual circumstances. In reality this means remuneration committees considering emoluments, in light of comparative data from within the higher education sector as required by the Code, and balancing this with the need to recruit and retain senior staff and the requirement to demonstrate value for money in use of stakeholder funds. The data available to remuneration committees is extensive with both the Universities and Colleges Employers Association and the CUC monitoring and reporting on levels of senior pay.

Our longstanding guidance on the composition of remuneration committees is that membership should consist of at least three independent/lay members; this does not preclude remuneration committees from appointing independent members with educational experience.

Effectiveness of the process

Widely cited press coverage of Vice-Chancellor pay is often factually incorrect and unnecessarily inflammatory. In particular, comparing the individual increases of heads of institutions to the basic, nationally negotiated, pay award made in the HE sector is misleading as many staff receive additional pay increases due to incremental pay progression awards, contribution-related pay, and promotion.

Furthermore, headline salary figures for Vice-Chancellors do not account for the total cost of the post to the institution; a more accurate measure is total emoluments received by post holders. The recent THE article³ found that in 2012/13 the value of Vice-Chancellors' and Principals' emoluments increased by 3.3 per cent against an average of 3 per cent for increases received by non-senior staff at most universities in the same year.

On another measure, the Hutton Review on Fair Pay in the public sector (2011) proposed that "*median earnings are a more representative measure of the pay of the whole workforce.*" In this respect the Hutton review reported that the ratio of senior pay to median pay in higher education, consistently in the region of 6:1⁴, was lower than both the Civil Service and the Military⁵.

Conclusion

Governing bodies and their remuneration committees take their responsibilities to meet the leadership requirements of their institutions and demonstrate good use of public funds very seriously. The CUC welcomes the public interest in remuneration practices as we believe the evidence suggests that they are robust and that Vice-Chancellors' and Principals' pay reflects the contribution they make to their institutions and communities as well as the reputation of UK higher education.

That is not to say that further improvements, particularly in the transparency of the processes, cannot be made and we are currently working to update our guidance to include strong illustrative practice from across the UK and would be happy to share this with the inquiry when it is completed later in the year.

³ Times Higher Education pay survey, 2014, THE 3 April 2014.

⁴ Sources: UCEA Senior Staff Remuneration Survey and the ONS. Ratio is calculated based on median average total pay for Heads of Institution and median full-time earnings in the HE sector.

⁵ Hutton Review on Fair Pay in the public sector, 2011, p. 33 Chart 2A

Appendix: Excerpt from the Governance Code of Practice⁶

2.46. Governing bodies should establish a remuneration committee to determine and review the salaries, terms and conditions (and, where appropriate, severance payments) of the head of institution and such other members of staff as the governing body deems appropriate.

2.47. Membership of such a committee should include the chair of the governing body, at least three other lay/independent members (not necessarily members of the governing body) and the lay treasurer if such an office exists, from among whom a committee chair should be appointed. The head of the institution may be a member of the committee, but in any case should be consulted on remuneration relating to other senior post-holders and should attend meetings of the committee, except when the committee discusses matters relating to his/her own remuneration.

2.48. The remuneration committee must seek comparative information on salaries and other benefits and conditions of service in the higher education sector. Two sources of information are available: the CUC has a database of salaries, benefits and conditions of service for heads of institution (currently available only to chairs of governing bodies); and the Universities and Colleges Employers Association (UCEA) collects data on the salaries of other senior staff.

2.49. If considering severance arrangements for senior staff, the remuneration committee must represent the public interest and avoid any inappropriate use of public funds. The committee should be careful not to agree to a severance package which staff, students and the public might deem excessive. Contracts of employment for senior staff should specify periods of notice of not more than 12 months, and should not provide for pension enhancements.

2.50. The remuneration committee's reports to the governing body should provide sufficient detail of the broad criteria and policies against which decisions have been made.

⁶ The Code is published on the CUC website and available at: <http://www.universitychairs.ac.uk/wp-content/uploads/2014/02/Current-Code.pdf>

Welsh Assembly Public Accounts Committee inquiry into senior management pay

I write in response to your request for a written submission as evidence to the Public Accounts Committee in relation to value for money aspects of the pay of senior managers in the Welsh public sector.

1. Status and funding of Universities

1.1 Universities are autonomous charitable organisations which exist for the promotion of public benefit through the delivery of education and advancement of knowledge. As charitable institutions, Universities are not public sector bodies but are in receipt of public funding.

1.2 The levels of public funding are changing. Historically the principal sources of public funding for the HE sector in Wales took the form of recurrent grants for teaching and other activities made via HEFCW. There has been a gradual change in the funding mechanism since the introduction of student loans in England and the tuition fee grant for Welsh domiciled and EU students. As stated in the Explanatory Memorandum accompanying the HE Wales Bill:

“Following the introduction of the non-means tested tuition fee grant, funding which was previously provided by the Welsh Government to HEFCW and then allocated by HEFCW to institutions in Wales, was re-directed to the Welsh Government’s student support budget. The amount of financial support paid by HEFCW to institutions in Wales has reduced.”¹

1.3 The proportion of income to Universities in Wales from direct grant from the Funding Council is set to become less than 10% of universities’ income over the next few years. Meanwhile, tuition fee grant arrangements are working through the system. HEFCW’s circular on Funding Allocations in May 2014² states that in 2013/14, Welsh institutions have received £10M less from HEFCW than anticipated while HEFCW support for English universities through the tuition fee grant has increased by £4M more than projected. The position for 2014/15 is likely to continue this trend:

“For the payments for fee grant to Welsh-domiciled students studying elsewhere in the UK, for the purposes of modelling, we have concluded that the original estimates for 2014/15, based on WG projections, were too low when compared to the fee grant for 2013/14, early forecast modelling and SLC data.”

1.4 While universities benefit from public funding it is noteworthy that this forms only one source of income: a diverse mix of other funding and income generation supports much university activity, particularly in areas of research, innovation and business/industrial partnerships.

The Higher Education sector

1.5 The success of a University is judged on its ability to attract and educate high calibre students; to attract and retain high quality academic staff who can educate, research, innovate and engage with business and industry; and on its collective performance against all these measures. Higher Education institutions compete against each other in all these arena. While co-operation between universities is possible and does happen through formal partnerships, there are clear areas where competition law applies to University activities and sharing of information between universities has to be carefully considered to avoid potential breach.

¹ Higher Education (Wales) Bill, Explanatory Memorandum, p8 para 12.

² W14/18HE, 23 May 2014,

www.hefcw.ac.uk/documents/publications/circulars/circulars_2014/W14%2018HE%20HEFCW%20funding%20allocations%202014_15.pdf

- 1.6 Pay for most staff in the HE sector is governed by a National Framework Agreement with grades set against a nationally negotiated pay spine. Pay for clinical academics is determined by the NHS.
- 1.7 Pay for professors and senior staff is determined locally giving institutions flexibility to tailor reward arrangements in light of their mission, strategic imperatives and market conditions. The introduction of the periodic Research Assessment Exercise and its successor, the Research Excellence Framework, has created a particularly strong market between universities for successful research academics who have the capability and capacity to lead research and to drive forward the research agenda in their discipline. The translation of such research into partnerships with business and industry contributes strongly to economic development. The importance of recruiting stellar research leaders has been recognised by the Welsh Government's Ser Cymru programme.
- 1.8 The success of a university is dependent on its ability to recruit staff of the appropriate quality and calibre. Universities compete with other world-leading universities both in the UK and overseas.
- 1.9 Salaries at Cardiff University are therefore consistent with its standing as Wales' only member of the Russell Group of leading UK research Universities, which attracts a geographically diverse range of students; collaborates with worldwide institutions, governments and businesses; and conducts research that is proven to have global significance and impact. In doing so the University contributes significantly to Wales in terms of the economy, social equality and international profile.
- 1.10 Our Universities are very complex organisations and highly internationalised. They must excel across a wide range of research and education activities. Salaries need to be competitive internationally if we are to attract and retain the best talent.

2 Cardiff University – Governance arrangements for senior pay

- 2.1 Cardiff University is a chartered pre-1992 University and has governance arrangements and management structures typical of many universities in that part of the sector. (Post-1992 Universities have their own governance arrangements, dependent on their form and legal structure at the point of becoming a University.)
- 2.2 Cardiff University is governed by a Council with a lay majority. The Council is very much aware of its responsibilities in relation to senior remuneration and of the importance for decisions on pay at all levels to be based on sound and robust principles. Members of the Council are trained in equality and diversity.
- 2.3 In accordance with the sector's governance code³, the University has a Remuneration Committee which sets the pay policy for its senior staff. All senior staff pay is managed on a strategic basis by the University's Remuneration Committee.
- 2.4 The Remuneration Committee has set a policy appropriate for Cardiff University as a member of the Russell Group. This policy, for the reasons set out above, is confidential and has not been shared with other institutions. There is no single senior staff pay policy across the higher education sector. The autonomy to develop, within recognised practice and standards, individual approaches to governance and senior remuneration reflecting institutional context and mission is critical to both the success of HEIs and the sector as a whole.
- 2.2 The Remuneration committee forms part of the formal governance arrangements of the University, and reports to its governing body.

³ *The Guide for Members of Higher Education Governing Bodies in the UK* incorporates the Governance Code of Practice and General Principles, <http://www.universitychairs.ac.uk/wp-content/uploads/2014/02/Current-Code.pdf>

- 2.3 The Governance Code of Practice published by the Committee of University Chairs sets out a framework for governance in the HE sector, including the role of remuneration committees. Although universities are not required to adhere to the CUC Code, they are required to have due regard for it, and in practice the arrangements at Cardiff, as at most universities, is similar to those indicated by the CUC Code. The full CUC guidance is at **Annex A**.

3. Remit of Cardiff University's Remuneration Committee

- 3.1 The Remuneration Committee's remit is set out in the University's Ordinances:

The Committee shall review and determine the salaries, terms and conditions and, where appropriate, severance conditions of the President and Vice-Chancellor and such other members of staff as the Council deems appropriate including non-clinical Professors and those on equivalent academic and related grades, taking into account comparative information on salaries and other emoluments and conditions of service in the university sector and elsewhere as appropriate.

- 3.2 Cardiff University's Council given the Remuneration Committee the remit to determine the salary of the President and Vice-Chancellor and of senior members of staff. Senior members of staff include: the Vice-Chancellor's direct reports; the Heads of academic Schools; the Heads of Professional Services departments; all professors; all professional services staff on grade 9 (i.e. those on the local senior staff pay spine).

4. Membership of the Remuneration Committee

- 4.1 The Remuneration Committee comprises of the following members, and reflects the advice in the CUC guidance⁴:

- (a) Chair of Council - Mr J Jeans
- (b) Vice-Chair of Council - Dr G Treharne
- (c) Two lay Council representatives: Mrs G Williams & Professor S Palmer
- (d) Vice-Chancellor - Professor C Riordan
- (e) Deputy Vice-Chancellor - Professor E Treasure

The secretariat function is carried out by the Chief Operating Officer, Jayne Dowden.

- 4.2 No member of staff is present for the discussion of his/her own salary or if there are other conflicts of interest.
- 4.3 Lay members bring a wealth of experience from a range of sectors/ industries, and have significant experience of managing reward issues.

5. Operation of the Committee

- 5.1 All Senior Staff Pay is managed by the University Remuneration Committee, and enacted by the University following core principles set down by this committee. There is a strict and transparent process for consideration of the salary of any member of the senior staff and, following review by the Remuneration Committee, the Council considers and publishes its Senior Staff Pay Policy on an annual basis. The pay policy includes a statement of the principles of reward:

Principles

Cardiff University seeks to adhere to the following reward principles in determining pay for senior staff:

⁴ Committee of university Chairs, *Guide for Members of Higher Education Governing Bodies in the UK* (2009), p.27.

1. *The process for remunerating senior staff will be clear and transparent.*
 2. *The University will monitor actively the external market with the aim of remaining fully competitive with UK-based research intensive institutions and the Russell Group. This includes consideration of salary levels in other institutions and whether there is a trend for senior salary reviews to be conducted, restricted or suspended.*
 3. *Pay increases will be clearly differentiated according to performance. Performance in line with role expectations will be rewarded with a pay increase that maintains pay competitiveness within the sector by application of any nationally negotiated pay award.*
 4. *The University will gear performance awards to those that are adding most value to the University. High or exceptional performance will be defined by reference to the strategic aims of the University.*
 5. *The financial framework for determining senior staff remuneration will take into account the impact on total costs of employment, not just the cost of actual pay increases. This includes such considerations as the on costs of employment e.g pension costs and national insurance contributions.*
- 5.2 The Remuneration Committee considers annually whether there should be a review of senior staff pay.
 - 5.3 Remuneration for members of the University Executive Board is determined by the Remuneration Committee. The Remuneration Committee considers and approves remuneration recommendations for other members of senior staff. Decisions are based on the performance and achievements of the senior staff over the year, and supported by comprehensive management information
 - 5.4 The Remuneration Committee meets twice a year, and has a range of performance information available to it including comparative salaries both inside and outside of the University.
 - 5.5 In exceptional circumstances only, the University may review pay for individual job-holders during the course of the year. The Remuneration Committee delegates to the Chair of the Remuneration Committee and/or the Vice-Chancellor the ability to make decisions on such out-of-cycle reviews. All such awards are reported to the Committee's next meeting.
 - 5.6 CUC guidance states that in making its deliberations committees should take into account other salaries in the HE sector:

The remuneration committee must seek comparative information on salaries and other benefits and conditions of service in the higher education sector. Two sources of information are available: the CUC has a database of salaries, benefits and conditions of service for heads of institution (currently available only to chairs of governing bodies); and the Universities and Colleges Employers Association (UCEA) collects data on the salaries of other senior staff.⁵
 - 5.7 The Remuneration Committee's work is informed by comparative information on salaries and other benefits and conditions of service in the higher education sector. Two sources of information are available: the CUC has a database of salaries, benefits and conditions of service for heads of institution (currently available only to chairs of governing bodies) and the Universities and Colleges Employers Association (UCEA) collects data on the salaries of other senior staff.
 - 5.8 Senior staff are appointed to a spot salary on a pay spine based on consideration of three elements: role responsibilities, market worth and relevant internal pay differentials. Pay is proportionate with

⁵ *Guide for Members*, p.27.

the responsibilities of senior staff roles within a Russell Group University with large staff and student numbers.

- 5.8 The policy and principles apply in determining starting salaries for internal appointments/promotions as well as for external recruits. All staff on grade 5 and above have access to the Universities' Superannuation Scheme (USS) to which employers currently contribute 16% of salary. The total value of the package (base pay plus employer's pension contribution) is quoted where comparative data is given to aid comparison.

President and Vice-Chancellor pay

- 5.9 Sample comparative data for the role of President and Vice-Chancellor at Cardiff University are shown in Appendix B. Such data are made available to the Remuneration Committee. This role is one which UK, Australian and American universities look internationally to fill as higher education increasingly has a global focus. These data include:

- Table 1: salaries of Presidents and Vice-Chancellors in the Russell Group
- Table 2: salaries of Presidents and Vice-Chancellors in Wales
- Table 2: salaries of Presidents and Vice-Chancellors in Australia
- Table 4: salaries of Presidents and Vice-Chancellors in USA.

The Council and Remuneration Committee of Cardiff University had regard both to the international, UK and Welsh data when setting and reviewing the President and Vice-Chancellor's salary.

Senior manager pay: academic leaders

- 5.9 As a chartered university, Cardiff operates a rotational model for senior academic leadership positions. This means that its Pro-Vice Chancellors and Heads of academic schools are appointed to these academic leadership positions for fixed terms of office, while continuing to make an academic contribution in teaching and research. In a Russell Group institution it is important for the credibility of such academic leaders that they have a strong track record in academic activity and that they seek to maintain this.
- 5.10 Those undertaking senior academic leadership responsibilities are paid a Senior Management Allowance for the fixed period that they occupy these roles. This allowance is removed at the end of the Senior Management role. The underlying base salary is determined in the same way as other holders of professorial posts.

Professorial pay

- 5.11 Professorial staff are recruited following international search for candidates able to make the contribution necessary to enable Cardiff University to achieve its ambition to be in the top 100 universities world-wide and in the top 25 in the UK. There is an intensely competitive market for such staff as already indicated. The following figures show the upper quartile, median and lower quartile figures for professors across the Russell Group.

Base pay			Base pay plus pension		
lower decile	median	upper decile	lower decile	median	upper decile
£74,993	£79,678	£89,594	£86992	£92426	£103929

Some Russell Group universities have professorial pay policies which involve the payment of supplementary allowances. This is not a practice at Cardiff University.

Senior manager pay: professional services managers

- 5.12 Senior management posts for professional services are externally advertised on a national basis. There is a competitive market for senior professionals with the relevant skills set to operate in the current changing and challenging environment. Comparative annual pay data is obtained via the Universities and Colleges Employers Association and the Russell Group.
- 5.13 Three senior professional services managers are members of University Executive Board and have salaries in excess of £100,000. Each is paid below the median for their role in other Universities in the sector and for other comparably sized organisations.

Clinical Academic salaries

- 5.13 The final segment of senior staff, the clinical academics, are employed on NHS pay scales. These staff have access to clinical excellence schemes in the same way as NHS consultants which give rise to salaries in the senior manager range. Over eighty such staff are employed at Cardiff University.

6 Conclusion

- 6.1 The University hopes that this information clarifies how remuneration works in the sector. It is the view of Cardiff University's Remuneration Committee that it controls the setting and review of salaries for all its senior staff and that it has due regard for equality and diversity considerations in so doing.

May 2014

Appendix A:

Excerpt from the Chairs of University Councils' Governance Code of Practice⁶

2.46. *Governing bodies should establish a remuneration committee to determine and review the salaries, terms and conditions (and, where appropriate, severance payments) of the head of institution and such other members of staff as the governing body deems appropriate.*

2.47. *Membership of such a committee should include the chair of the governing body, at least three other lay/independent members (not necessarily members of the governing body) and the lay treasurer if such an office exists, from among whom a committee chair should be appointed. The head of the institution may be a member of the committee, but in any case should be consulted on remuneration relating to other senior post-holders and should attend meetings of the committee, except when the committee discusses matters relating to his/her own remuneration.*

2.48. *The remuneration committee must seek comparative information on salaries and other benefits and conditions of service in the higher education sector. Two sources of information are available: the CUC has a database of salaries, benefits and conditions of service for heads of institution (currently available only to chairs of governing bodies); and the Universities and Colleges Employers Association (UCEA) collects data on the salaries of other senior staff.*

2.49. *If considering severance arrangements for senior staff, the remuneration committee must represent the public interest and avoid any inappropriate use of public funds. The committee should be careful not to agree to a severance package which staff, students and the public might deem excessive. Contracts of employment for senior staff should specify periods of notice of not more than 12 months, and should not provide for pension enhancements.*

2.50. *The remuneration committee's reports to the governing body should provide sufficient detail of the broad criteria and policies against which decisions have been made.*

⁶ The Code is published on the CUC website and available at: <http://www.universitychairs.ac.uk/wp-content/uploads/2014/02/Current-Code.pdf>

Appendix B

1. Russell Group financial comparisons - 2012/2013

University	Total Staff	Total Income (£ '000)	Staff costs (£ '000)	President & Vice-chancellor 2012-13 emoluments details			
				Salary (£)	Other benefits (£)	Pension (£)	Total (£)
LSE	3135	263,213	130,849	£324,000	£97,000	£45,000	£466,000
Oxford	11180	1,086,900	541,600	£380,000	Not stated	£54,000	£434,000
Birmingham	6320	492,625	263,453	£400,000	included in salary	£0	£400,000
Sheffield	6115	484,800	247,500	£370,000	£4,000	£0	£374,000
University College London	9345	940,019	516,611	£315,028	£0	£50,404	£365,432
Liverpool	5095	392,900	216,100	£360,000	included in salary	£0	£360,000
Nottingham	7315	561,900	295,200	£313,000	£44,000	£0	£357,000
Exeter	3880	280,360	152,535	£290,000	Not Stated	£52,000	£342,000
Cambridge	9380	1,438,000	605,000	£289,000	Not Stated	£45,000	£334,000
Southampton	5735	447,221	250,770	£294,000	Not stated	£39,615	£333,615
Warwick	5055	459,600	224,800	£332,000	included in salary	£0	£332,000
Imperial College	7265	822,000	392,900	£309,000	£21,000	£0	£330,000
Leeds	7115	547,601	301,773	£318,000	£7,000	£0	£325,000
Bristol	5535	459,200	246,300	£318,700	£2,300	£0	£321,000
King's College London	6695	586,948	349,889	£267,000	£5,000	£49,000	£321,000
Glasgow	5840	468,953	249,558	£258,000	Not Stated	£41,000	£299,000
Manchester	9455	826,970	424,055	£248,000	£4,000	£40,000	£292,000
Edinburgh	8390	737,786	377,265	£227,000	£2,000	£57,000	£286,000
Durham	4100	283,379	155,773	£244,000	Not Stated	£39,000	£283,000
Newcastle	5505	405,300	218,800	£222,000	£1,700	£55,900	£279,600
York	3455	286,641	153,818	£271,783	£5,168	£0	£276,951
Cardiff University	6050	436,685	249,121	£216,000	£2,000	£34,000	£252,000
Queen Mary London	3935	232,609	196,104	£201,000	£3,000	£32,160	£236,160
Queen's Belfast	3410	286,090	158,326	£230,000	Not stated	£0	£230,000

2. Welsh University financial comparisons 2012/13

University	Total Staff	Total income (£ '000)	Staff costs (£ '000)	President & Vice-chancellor 2012-13 emoluments details			
				Salary (£)	Other benefits (£)	Pension (£)	Total (£)
Aberystwyth	2295	119,224	66,959	£228,000	Not Stated	£24,000	£252,000
Cardiff	6050	436,685	249,121	£216,000	£2,000	£34,000	£252,000
Swansea	2625	182,294	103,910	£235,000	£6,000	£0	£241,000
Cardiff Metropolitan	1270	80,948	48,088	£206,328	£19,558	£0	£225,916
Bangor	2175	135,361	76,279	£221,000	Not Stated	£0	£221,000
South Wales	2586	192,545	115,808	£190,000	Not stated	£26,672	£216,672
Glyndwr	655	43,884	26,992	£201,627	£13,270	£0	£214,897
Royal Welsh College of Music & Drama	162	11,675	6,145	£129,000	Not Stated	£15,000	£144,000
University of Wales, Trinity Saint David	855	35,652	20,043	£91,000	£14,000	£14,000	£119,000

3. Top 20 Rankings of US Institutions as defined by the National University Rankings from US News

Information from *The Chronicle of Higher Education 2011*, converted from US Dollars to Pounds Sterling with an exchange rate of 0.6 as at 30 May 2014

USA Top 20 Universities	President Remuneration as at 2011	
	Base Salary (£)	Total Salary (£)
University of Chicago	£550,796	£2,015,234
Columbia University	£593,201	£1,396,406
University of Pennsylvania	£646,810	£1,255,058
Yale University	£630,605	£991,526
Northwestern University	£471,102	£813,037
Brown University	£385,843	£775,266
Vanderbilt University	£430,978	£740,849
Emory University	£522,242	£720,380
Massachusetts Institute of Technology	£417,632	£719,926
Washing University in St. Louis	£489,632	£718,364
Duke University	£459,175	£710,721
Johns Hopkins College	£515,733	£710,721
Rice University	£473,156	£706,933
Stanford University	£440,807	£648,674
Princeton University	£437,952	£561,196
Dartmouth College	£460,897	£550,575
Harvard University	£432,265	£539,840
Cornell University	£420,502	£523,293
University of Notre Dame	£353,429	£447,841

Australia: Group of Eight (Russell Group) research intensive Universities

Information from *Financial Accounts 2012*, converted from Australian Dollars to Pounds Sterling with an exchange rate of 0.56 as at 30 May 2014

University	Staff Numbers	Total income (£ '000)	Vice-chancellor/ Principal 2012 emoluments details
			Salary (£)
Western Australia	4025	£462,520	£529,200
Melbourne	7937	£945,184	£562,800
Monash	8071	£841,103	£618,800
UNSW Australia	3484	£823,060	£512,400
Australian National University	4413	£561,573	£464,800
Queensland	7704	£918,691	£660,800
Adelaide	3684	£419,692	£514,080
Sydney	7519	£894,398	£518,000

Public Accounts Committee

Inquiry into Senior Management Pay

During the evidence session with Delyth Jones, Head of Law & Governance and Monitoring Officer, Conwy County Borough Council on 13 May, she agreed to send further information on the cross party make-up of the Employment sub-committee at Conwy County Borough Council.

Her response is below:

The Senior Employment Committee in Conwy is made up of cross-party Members including Members of the Opposition Group. It is Chaired by the Leader of the Council with the Leader of the Opposition being the Vice-Chair. It is not a sub-Committee as I erroneously described it yesterday (that was its predecessor).



Charter for Good Governance: supporting guidance

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Charter for Good Governance

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Charter for Good Governance

Community Housing Cymru has developed this Charter to enable its members to demonstrate a visible commitment to good governance. It is supported by detailed guidance set out in the document **Charter for Good Governance: supporting guidance** which is available for CHC members to draw on as they develop and refine their governance policies, procedures and practice.

As a member of CHC, [name of organisation] commits to achieving the highest standards of governance, specifically to:

- put existing and potential service users at the centre of our work
- have in place practical mechanisms to achieve accountability to tenants, residents, potential tenants and residents, shareholders and all relevant stakeholders
- develop and maintain positive and constructive relationships with key stakeholders, including funders and regulators
- communicate openly about all aspects of the organisation, including strategic direction and purpose, values, standards, performance and how complaints can be made
- maintain and demonstrate organisational independence
- be clear about the roles and responsibilities of the Board, the Audit Committee, any sub committees, boards of any subsidiaries of group structures where relevant, and the Chief Executive and document these
- support Board members through provision of a job description, information, training and appraisal
- have in place mechanisms for regular Board review and recruitment
- have a transparent process for deciding the remuneration of the Chief Executive
- have in place mechanisms to improve services and ways of measuring when they have improved
- have in place practical ways to effectively manage risk
- develop and demonstrate effective means of financial management
- ensure value for money is achieved
- practically demonstrate a commitment to equality and diversity

Signed _____ Date _____
Name/role _____

1 Background and introduction

Background

As the new regulatory framework is implemented, housing association/community mutual governance arrangements are likely to be more closely scrutinised than has been the case in the past. The Essex Review¹ noted:

'We have responded to the appetite for a regime built around a stronger role for self assessment, but we have also recommended an upgrading related to finance and governance across the system'

However, it is also clear that, within this context, there is the potential for greater autonomy for the sector, again to quote the report of the Essex Review:

*'In applying the **Making the Connections**² model, housing would be aligning itself with other policy changes in public service delivery taking place within Wales. This would see:*

- *housing associations being given more freedom to release resources, develop and innovate but within a clearer, risk and performance based regulatory framework'*

Welsh Assembly Government circular RSL 33/09 **Self Assessment – guiding principles for Housing Associations in Wales**³ notes that self assessment should cover three areas – service delivery, financial viability and management and overall corporate governance. The fundamental question that housing associations/community mutuals should ask themselves in relation to governance is:

'Do we have effective governance in place to ensure that we meet our aims and objectives, that our services will improve and that we will remain financially viable?'

Community Housing Cymru believes that governance works best where there is shared understanding and ownership by all parties involved in running and directing the work of housing associations and community mutuals. The process of self assessment, which will have regard to national performance standards established by the Welsh Assembly, can assist in developing this shared understanding, as can board appraisal or board effectiveness reviews.

It is important to emphasise that effective governance is not an end in itself, but is a means to ensuring the sustainable delivery of quality services which citizens want.

¹ The Essex Review report is available online at

<http://new.wales.gov.uk/desh/publications/housing/essexreview/reporte.pdf?lang=en>

² A series of documents setting out the Welsh Assembly Government's approach to improving public services is online at

http://new.wales.gov.uk/topics/improvingservices/strategy/;jsessionid=hxPxLPnLw5Xc4YZCdhVxZv9FL75y_sxQCTCHmrhG5RNCdqBIQpkkh!461668963?lang=en

³ The circular is online at

<http://new.wales.gov.uk/topics/housingandcommunity/housing/social/management/circulars/rs13309/?lang=en>

This document

This document sits alongside Community Housing Cymru's **Charter for Good Governance**, launched in May 2010⁴. Both documents have been informed by consultation with housing associations and community mutuals across Wales. A written consultation exercise ended in early March 2010 and two consultation events were held in January 2010 jointly with the Welsh Assembly Government. Community Housing Cymru would like to take this opportunity to thank everyone for their contributions to the development of these documents.

Community Housing Cymru is the trade body for housing associations and community mutuals across Wales, all of which are not for profit organisations run by voluntary boards. It recognises the opportunity that exists for its members to set their own standards for governance. This document provides detail which individual housing associations and community mutuals may wish to consider as they further develop their work on governance. It takes account of the emerging regulatory framework in Wales and is intended to support Community Housing Cymru members to continue to follow the highest standards of governance, thereby maintaining and enhancing the reputation of the sector.

In late 2009, the Assembly consulted on a set of performance standards relating to governance and management⁵. Given the centrality of the Assembly's citizen-centred principles of governance to these standards, this document is structured around the citizen-centred principles which are set out at the start of Section 2. Ensuring sound financial management and viability is covered in Section 3.

The detail of this document draws on a range of good practice in governance from across the UK, as well as being firmly seated within the Welsh **Making the Connections** context which has at its heart the delivery of citizen-centred services⁶. Much of the detail will be familiar to board members and others, but some may be less so.

This document and the Charter are part of Community Housing Cymru's programme of work to support effective governance across the housing association and community mutual sector in Wales. This programme includes:

- a regular Board Members Briefing⁷
- Board Member seminars run in conjunction with Central Consultancy and Training⁸
- training courses for Board Members
- the annual Governance Conference⁹
- regional Board Member Networks
- the development of good practice examples featured on the good practice section of the Community Housing Cymru website

⁴ The Charter is included at Appendix 1

⁵ Welsh Assembly Government (2009) **Developing a modern regulatory framework for Housing Associations in Wales: Performance Standards 1st Phase Consultation**
<http://wales.gov.uk/docs/desh/consultation/091201housingperformanceen.pdf>

⁶ Appendix 2 sets out useful references and further sources of information

⁷ Online at <http://www.chcymru.org.uk/boardmemberbriefing.html>

⁸ Information at <http://www.chcymru.org.uk/products/training/boardtraining.html>

⁹ Information at <http://www.chcymru.org.uk/products/conferences.html>

Community Housing Cymru recognises that, while it can support good governance, much of the work will need to take place at the individual housing association/community mutual level and will link directly to the values and culture of individual organisations.

Parts 2 and 3 of this document contain recommendations from Community Housing Cymru. These issues are felt by Community Housing Cymru to be critical to effective governance. Further detail is provided as boxed text. The intention is that organisations use and adapt this detailed information as they see fit. In responding to the feedback received during the consultation period, we have tried to strike a balance between retaining detail for those who felt that it was useful, but avoiding being overly prescriptive.

Links to further information and good practice are also provided as relevant. Community Housing Cymru commits to including governance within its work on identifying and disseminating good practice, making relevant examples of good practice available to the sector.

Each housing association and community mutual will have a constitution, including a set of Rules or Memorandum and Articles and Standing Orders which guide the way in which the organisation works and to which they need to adhere. In order to facilitate improvements in governance, from time to time, it may be appropriate to make changes to these documents. Making such changes may be a response to:

- changes by the organisation such as a decision to broaden the objects of the organisation, form a group structure, or make changes to an existing group structure
- the results of a governance review of self-assessment concluding that current arrangements are not fit for purpose

A note on terminology

During the consultation, there was significant debate about the use of specific terms in this guidance, most particularly citizen (as opposed to tenant or customer) and public service values.

Given the rationale for this document to be aligned to the Welsh Assembly Government performance standards on governance and management which are in turn based around the Assembly's citizen-centred governance principles, it has been agreed that use of the word "citizen" is appropriate and therefore will remain in the document.

- Citizen is used as an all-encompassing term for tenants, residents and members of the community
- Public service values is used as this is an integral part of the performance standards on governance

However, Community Housing Cymru acknowledges that each housing association or community mutual will use its preferred terminology in any documents they produce to support high standards of governance (such as Codes of Governance, governance improvement plans etc).

The link to regulation

Welsh Assembly Government regulation will be focused around housing association/community mutual delivery against the Welsh Assembly Government's performance standards¹⁰. In their dialogue with housing associations/community mutuals, Welsh Assembly Government regulators will have regard to the application and implementation of Community Housing Cymru's Charter for Good Governance.

Reviewing this document

The regulatory framework is still in the process of being developed. At the time of writing, it is still unclear how judgements about housing association/community mutual performance will be made by the Welsh Assembly Government and there is a commitment to consult on board member payment at some point in the future. Given this, it will be necessary to regularly review the content of this document to ensure it continues to be aligned with the regulatory framework. Community Housing Cymru will review this document on an annual basis.

Community Housing Cymru contact

For more information about Community Housing Cymru's work on governance, contact:

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amanda-oliver@chcymru.org.uk

029 2055 7404

¹⁰ Performance standards on governance and management and the activity standards.

2 Citizen-centred governance principles

The Welsh Assembly Government's citizen-centred governance principles are:

- **Putting the citizen first** – putting the citizen at the heart of everything and focussing on their needs and experiences; making the organisation's purpose the delivery of a high quality service
- **Knowing who does what and why** – making sure that everyone involved in the delivery chain understands each others' roles and responsibilities and how together they can deliver the best possible outcomes
- **Engaging with others** – working in constructive partnerships to deliver the best outcome for the citizen
- **Living public service values** – being a value-driven organisation, rooted in Nolan principles¹¹ and high standards of public life and behaviour, including openness, customer service standards, diversity and engaged leadership¹²
- **Fostering innovative delivery** – being creative and innovative in the delivery of public services – working from evidence, and taking managed risks to achieve better outcomes
- **Being a learning organisation** – always learning and always improving service delivery
- **Achieving value for money** – looking after taxpayers' resources properly, and using them carefully to delivery high quality, efficient services

These principles are underpinned by a straightforward definition of governance:

'the way in which organisations direct their business and engage with the communities they serve.'

¹¹ The seven Nolan principles are selflessness, integrity, objectivity, accountability, openness, honesty and leadership

¹² Public Service Management Wales has published a series of documents on key themes including engaged leadership. These are online at <http://wales.gov.uk/psmwsubsite/psmw/newseventpubs/publications/sowingseeds/?lang=en>

2(A) Putting the citizen first

A1 Citizen focus

Community Housing Cymru acknowledges that putting people first and involving them in the design of services is central to achieving improvement. Real improvements can be delivered by engaging people in shaping and scrutinising services.

Practical issues for consideration by Community Housing Cymru members will include:

- being clear about which citizens they serve, eg tenants, leaseholders, applicants for housing, people who are homeless
- regularly keeping in touch with what the citizens they serve want, and what they think about the services they receive
- changing how they do things to meet the expectations of the citizens they serve, or explaining why such changes cannot be made
- involving citizens at an early stage in shaping their services and reviewing performance on an ongoing basis
- treating citizens with dignity and respect
- providing accessible systems for requests for information, complaints to be made and for people to seek redress
- providing feedback on what has been changed as a result of people providing their views about services

A2 Accountability

Community Housing Cymru members need to be accountable in different ways to a wide range of stakeholders, including tenants, residents, service users, potential tenants and residents, shareholders, local authorities, regulators, funders and other community and neighbourhood interests. Accountability through appropriate structures is a fundamental principle of governance, but is only one part of an overall approach to accountability.

Steps that any Community Housing Cymru member can take to contribute to improving accountability may include:

- identifying the range of stakeholders to which it is accountable and ensuring that each group has appropriate ways of being informed and informing, influencing, or getting involved in planning and decision making

- ensuring that a range of mechanisms are in place to inform and engage with tenants and residents and develop and publish policies for communicating with, and involving, tenants and residents
- in relation to shareholding members/members (as appropriate), defining the role and purpose of the membership and reviewing policies for admission to membership taking into account issues of equity, equality and accountability. In practical terms, the overall approach is likely to be set out in the organisation's Rules
- clarifying and, where appropriate, enhancing the role of shareholding membership in governance
- ensuring that the way in which the shareholding membership/membership is chosen is appropriate to the aims of the organisation and realistically and effectively serves that role
- ensuring that there is a procedure for appropriate dialogue with shareholding members/members, including providing them with regular information on the organisation's work, achievements and challenges, as well providing them with an opportunity to raise their concerns
- having a clear policy on shareholding members/members who are nominees of other organisations and employees or board members of other housing providers

A3 Independence

Community Housing Cymru members will wish to maintain and demonstrate organisational independence (other than subsidiaries in a group structure).

2(B) Knowing who does what and why

Clarity about the different parts of the governance structure within housing associations/mutuals, and their roles, is essential.

Community Housing Cymru **recommends** that housing associations/community mutuals consider the information, training and support that they provide to board members and others in order to ensure clarity about who does what within each organisation and why.

B1 Role and function of the board

The board has ultimate responsibility for the governance of the organisation and ultimate control over all aspects of the organisation's work to ensure that its financial, legal and service obligations are properly fulfilled.

The purpose of the board is to:

- set strategic direction
- define policies
- identify appropriate resources to put strategy and policy into practice
- ensure effective systems for evaluating the work of the organisation, internal control, risk management and communication and engagement with service users and stakeholders, (including in relation to setting strategic direction), are in place

All members of the board have equal responsibility for decisions that affect the success of the organisation. Each has a duty to act only in the best interests of the organisation and not on behalf of any constituency or interest group. Board members also have a role in promoting the success of the organisation.

Essential functions of the board will be set out in the organisation's constitutional documents (rules), terms of reference, standing orders and/or financial regulations.

Community Housing Cymru **recommends** that members consider the following as essential functions of the board:

- defining and ensuring compliance with the organisation's values and strategic objectives
- establishing a framework for approving strategies, policies and plans to achieve those objectives
- satisfying itself as to the integrity of financial information and approving annual budgets and accounts and business plans
- establishing and monitoring a framework for delegation and systems of internal control which are reviewed annually

- establishing a framework for the identification, management and reporting of risk
- taking decisions and agreeing policies on all matters that might create a significant financial or other risk to the organisation or that raise significant issues of principle
- establishing mechanisms for communication and receiving feedback from the organisation's stakeholders and shareholders
- monitoring the organisation's performance and taking timely corrective action if required
- taking overall responsibility for self-assessment
- appointing, managing and dismissing the chief executive. In group structures as relevant, appointing and dismissing other Corporate or Managing Directors
- satisfying itself that the organisation's affairs are conducted lawfully and with probity
- following the organisation's constitution in appointing and removing the chair of the board
- establishing a code of conduct for the board
- assuring the effectiveness of governance on a regular basis

Within its terms of reference, the board will identify a list of significant matters that cannot be delegated to staff or committees.

Community Housing Cymru **recommends** members consider the following as significant matters that cannot be delegated by the board to staff or committees:

- expansion of operations into new activities or geographical areas
- decisions to cease a material part of the organisation's operations
- changes to corporate structures, including the establishment of subsidiaries
- approval of resolutions to be put by the board to general meetings
- changes to the structure, size and composition of the board
- approval of committee membership and terms of reference
- appointments to the boards of subsidiaries
- appointment or removal of any officer (chair, vice-chair) of the board
- oversight of major capital projects

- ensuring adequate succession planning for the board and senior management appointments
- approval of key policies
- changes to the schedule of matters reserved for board decisions

B2 Composition of the board and responsibility of board members

Boards need to be of an appropriate size for the organisation to carry out business effectively and they need to work effectively as a team. Consideration of board composition can form part of board review processes which may be externally facilitated.

Boards as a whole will need to have, or acquire, a diverse range of skills, competencies, experience and knowledge. It is also important that board members commit themselves to the values and strategic objectives of the organisation.

It is up to each organisation to identify what skills and experience are needed around the board table in order to fulfil its business objectives and achieve its future strategy.

Community Housing Cymru members may wish to consider the following areas as required skills and experience for the board:

- leadership, team working and communication skills
- strategic thinking skills
- direct knowledge of the needs and aspirations of the communities and people served by the organisation
- general business, financial and management skills
- knowledge of the external environment in which housing associations/community mutuals work, e.g. financial, political, regulatory, policy environment
- relevant specialist knowledge and skills, e.g. financial, legal, risk management, health, social services, property management, housing development, commercial etc

Board members need to be clear about their role and responsibilities. One practical way of helping this is for there to be a board member role profile or job description. It is also common for organisations to have some sort of formal agreement setting out board members obligations which is signed by board members, eg a Code of Conduct, Code of Governance or Service Statement.

Community Housing Cymru **recommends** that members consider the following as responsibilities of board members:

- understanding and upholding the values and strategic objectives of the organisation
- understanding and upholding the organisation's core policies
- ensuring that they understand the constitutional and legal framework as it applies to the organisation and act within its powers
- ensuring that they are adequately informed about the organisation's affairs
- contributing to, and sharing responsibility for, board decisions
- preparing for and attending meetings, training sessions and other events in order to keep up to date with changes in the operating environment for housing associations/community mutuels
- actively participating in board effectiveness or governance reviews and individual board member appraisal (where this is undertaken)
- representing the organisation as appropriate
- declaring relevant interests and not taking part in associated discussions and/or decisions
- respecting confidentiality of information, policies and decisions
- upholding the organisation's code of conduct

A number of the above are legal duties as set out in the UK Companies Act 2006¹³.

B3 Committees

Housing associations/community mutuels may establish standing or other committees to oversee specified areas of work. Committees may have specific delegated responsibilities or be consultative. Housing associations/community mutuels may have regional, area or local committees.

Community Housing Cymru **recommends** that any committee:

- has clear terms of reference approved by the board
- has agreed reporting mechanisms to the board
- be clear about its delegated authority and procedures for reporting on the exercise of this authority
- has procedures for its meetings

¹³ The full Act is online at www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en_1

- has its purpose, terms of reference and delegated authority regularly reviewed

In the case of any dispute, the decision of the board must over-ride any committee.

B4 Board business

Board business should be conducted in an open and transparent manner.

Specific issues that Community Housing Cymru members may wish to consider include:

- ensuring board decisions are, wherever possible, based on full agendas and documents that are circulated to board members well in advance of meetings
- clearly identifying points for decision within papers
- ensuring decisions and the main reasons for them are recorded in the minutes
- having in place arrangements for making urgent decisions between board meetings. These will be set out in the standing orders of the organisation
- recording conflicts of interest and in these instances, ensuring that the individual(s) concerned are not involved in the discussion or decision
- having clear procedures in place for the removal of board members, e.g. in instances where conflicts arise that cannot be resolved. Where board members are elected, this needs to be taken into account
- ensuring the company secretary has a direct line of communication with the chair

B5 The Chair

The responsibilities of the chair should be formally set out to ensure clarity and transparency.

Community Housing Cymru **recommends** that members consider the following as responsibilities of the chair:

- ensuring the efficient conduct of board business and of the organisation's general meetings
- ensuring that appropriate standards of behaviour are maintained and that all board members are given the opportunity to express their views
- ensuring that the organisation provides appropriate induction, training, development opportunities and support for all board members

- establishing a constructive relationship with, and providing support for, the chief executive and ensuring the board as a whole works constructively with senior staff
- in conjunction with other board members, ensuring an appropriate system of appraisal for the chief executive and arrangements to determine the remuneration of the chief executive and other senior staff, is in place
- ensuring that the board delegates sufficient responsibility throughout the organisation to enable the business to be carried on effectively between meetings of the board and ensuring that the board monitors the use of these delegated powers
- ensuring that the board seeks and receives professional and independent advice when needed
- representing the organisation as appropriate
- taking decisions delegated to the chair
- taking the lead on board effectiveness reviews and board member appraisal where implemented
- ensuring the board agrees the role and responsibilities of any vice-chair

B6 The Chief Executive

Clear working arrangements between the board and the chief executive are a key element of effective governance. Clarity of their distinct and complementary roles is essential.

Community Housing Cymru members may wish to consider the following as essential duties of the chief executive:

- managing the affairs of the association in accordance with the vision, values and objectives of the association and the general policies and specific decisions of the board
- assisting and advising the board to determine the association's strategies, policies and business planning
- drawing the board's attention to matters requiring consideration and decisions and take actions to enable the board to undertake its duties
- ensuring that the board is given the information necessary to perform its duties and that it receives advice on matters concerning compliance with its governing instrument, the law and the need to remain solvent
- ensuring that proper systems of financial control, risk assessment and risk management and legal and regulatory compliance are established and maintained and that regular reports on these are provided, at least annually, to the board

- supervising, with the guidance of the chair, where necessary, the preparation of documents for consideration by the board
- helping the chair ensure that the business of the board is properly conducted
- ensuring that relationships between the senior staff and the board are positive and focus on the business of the organisation
- leading and managing the staff of the association and ensuring that their performance is appraised

Transparent systems should be in place for the appraisal of the chief executive and for making decisions about pay and other benefits.

Community Housing Cymru considers that it may be useful to apply the following principles to chief executive remuneration and appraisal:

- a remuneration package is sufficient to attract, retain and motivate the quality of chief executive required, but not be so generous as to bring the sector into disrepute
- there is full disclosure of all elements of the remuneration package, including salary, pension arrangements, periods of notice and compensation payable for loss of office
- remuneration decisions are clearly related to performance achievement, including over the long-term
- any performance-related elements of the remuneration package are linked to the achievement of specific and measurable targets reviewed on a regular basis, taking into consideration the need to balance long-term sustainable progress with annual achievements
- a robust system of appraisal is in place which is based on a full picture of performance
- the chief executive's contract includes procedures for monitoring performance and how complaints and disciplinary matters will be dealt with

B7 Group structures

The board of a parent organisation in a group structure has responsibility and power to direct the activities of its subsidiaries.

Community Housing Cymru **recommends** that the board of the parent organisation:

- controls the activities of all parts of the group and satisfies itself that all group members are meeting statutory and regulatory requirements and that their affairs are being conducted in accordance with generally accepted standards of performance, probity, financial prudence and good practice
- ensures that both parent and subsidiary organisations have a clear understanding of each other's vision, values and objectives

and that:

- representation from subsidiary boards to group boards ensures that there is a fair balance between the need to represent the interests of subsidiaries with the need for independence and scrutiny on group boards
- the powers, roles and relationships of each board are clearly specified in an appropriate document such as an intra-group agreement, and be well understood by all.

2(C) Engaging with others

The board has ultimate responsibility for ensuring the organisation develops positive and constructive relationships with its key stakeholders, including funders and regulators.

Community Housing Cymru **recommends** that boards satisfy themselves that:

- effective communication, reporting and feedback mechanisms are in place with the relevant range of stakeholders in the areas in which the organisation operates
- the organisation is appropriately engaged in partnership structures and working, in particular relating to local authorities in the areas in which it operates. Specifically, housing associations/community mutuals might expect to be engaged in:
 - the development and implementation of local authority statutory plans (the Community Strategy, Children and Young People's Plan and Health, Social Care and Well-being Strategy)
 - community-based strategic initiatives
- the partnership working in which the organisation is engaged has clear aims and responsibilities, is focused on providing better services, and there are mechanisms in place to evaluate the outcomes of partnership working. Such evaluation will assist organisations in demonstrating value for money

2(D) Living public service values

D1 Values

Community Housing Cymru **recommends** that:

- boards establish organisational values and ensure that these underpin the policies and operation of the organisation
- boards periodically review the values of the organisation, how the values are reflected by the work of the board (in its decision making, board behaviour etc) and whether working practices within the organisation reflect the values

Housing associations/community mutuals may wish to refer to the Good Governance Standard for Public Services, produced by the Independent Commission for Good Governance in Public Services, chaired by Sir Alan Langlands¹⁴.

D2 Conduct and probity

Housing associations/community mutuals have a reputation for high standards of conduct and probity. These standards are reinforced by legislation, regulation and the ethos of the not-for-profit housing movement, as well as by the provisions in organisations' constitutions. It is important that this reputation is maintained.

Community Housing Cymru **recommends** that its members:

- have a code of conduct for board members and staff which supports high standards of probity and ethics and make this available for public inspection
- ensure that major decision making resulting in benefits to individuals or companies is based on objective factors and is not unduly influenced by personal relationships
- ensure that the board from time to time reviews:
 - the values of the organisation and how they are implemented in practice
 - the implementation of the Charter for Good Governance
 - the codes of conduct adopted by the organisation for its board members and staff
 - policies and procedure relating to accepting and recording of hospitality, and gifts, whistle-blowing, access to information and other matters of business ethics
- consider any potential conflicts of interest and adopt policies limiting the number of board members who are paid staff or board members of other housing providers
- maintain records of the declared interests of board members and staff
- establish a policy on the receipt of hospitality and gifts by board members and staff to ensure compliance with Schedule 1 of the Housing Act 1996 (and related Welsh

¹⁴ Available online at www.audit-commission.gov.uk/SiteCollectionDocuments/Downloads/goodgovernancestandardopm.pdf

Assembly Government circular¹⁵), to ensure that no gifts of a significant monetary value are offered or given and that all gifts and hospitality are formally recorded

- ensure that proper arrangements are in place for the referral and determination of cases raising issues of ethics or probity. This will include a whistle-blowing policy
- ensure that any concerns raised by board members as to how the organisation is run and reasons for board member resignations are recorded in the minutes of the relevant board meeting

D3 Openness and transparency

Housing associations/community mutuals need to operate in an open, transparent and accountable way in relation to tenants, residents, service users, local communities, local authorities, employees, lenders, regulators and other stakeholders.

Community Housing Cymru **recommends** that its members:

- account for their actions in an open manner, including having a policy about access to their information and documentation which covers when information will not be made available. Information should generally be made available unless there are good reasons of confidentiality or practicality.
- publish information about their performance in addition to prescribed reports on finances
- comply with outside requests for information wherever practicable and appropriate
- at board level, review the openness of the organisation's arrangements on a regular basis

D4 Equality and diversity

The promotion of equality and diversity is a core value for all Community Housing Cymru members which needs to be embedded within policy and practice.

Community Housing Cymru **recommends** that its members:

- demonstrate through all their functions their commitment to equality and diversity
- adopt and publish a policy for promoting equality and diversity which includes how the organisation will promote equality in relation to all equality strands and the Welsh language, covering all areas of work of the organisation, including:
 - identification and assessment of need

¹⁵ Welsh Assembly Government Circulars are online at <http://new.wales.gov.uk/topics/housingandcommunity/housing/social/management/circulars/?lang=en>

- allocation of housing and other services
 - provision of services
 - membership and operation of the board and any committees
 - staff recruitment, selection, training and conditions of service
 - purchasing of goods and services and contracting procedures
 - service user involvement
-
- implement practical means by which equality and diversity is implemented, e.g. equality impact assessment
 - train and support board members and staff to ensure they understand the requirements and obligations of the organisation in relation to equality and diversity
 - record and publicise their achievements and performance in relation to equality and diversity

2(E) Fostering innovative delivery

E1 Continuous improvement

The board has ultimate responsibility for ensuring the organisation embraces continuous improvement.

Community Housing Cymru **recommends** that boards satisfy themselves that:

- adequate arrangements are in place to secure continuous improvement
- they receive comprehensive and appropriate information about the performance of the organisation so that they can assess whether continuous improvement is being achieved and contribute to discussions on areas of the business which are not improving

E2 Board recruitment, renewal and review

Boards need to agree, publicise and implement board renewal and succession planning arrangements to ensure planned refreshing and renewal of skills and experience (acknowledging the constraints posed by board member elections where these take place). While continuity at board level is important, it needs to be balanced with planned and appropriate renewal to aid new thinking and constructive challenge and contribute to innovation

Community Housing Cymru **recommends** that:

- new board members are recruited, selected or elected on a systematic basis
- a maximum term of office is set for the chair

Community Housing Cymru members may wish to agree and publish policies for:

- how new members will be recruited, selected or elected. It is useful to consider a broad range of recruitment methods, including open advertising. It may be appropriate to establish a committee which oversees board member renewal and recruitment
- agreeing a board member job description or role profile and competency frameworks
- the preferred composition of the board, e.g. skill mix, proportion of tenants/residents on the board
- board renewal, including maximum terms of office for board members, chair and other officers (some organisations will specify maximum terms of office within their Rules). Within group structures, it may be appropriate for board members to move between members of the group after agreed lengths of time
- succession planning for the chair

- circumstances in which individuals would be excluded from becoming or continuing to be a board member

Board members need to ensure that they receive the necessary induction, training and ongoing support they need in order to effectively carry out the responsibilities of being a board member.

Training and support may include:

- induction training when they become a board member to ensure that they are aware of their responsibilities and the practical support available to enable them to effectively undertake their role
- ongoing support to develop their skills, experience and knowledge based on an analysis of their training and development needs
- ongoing provision of information so that board members can keep up to date with the operating environment of the organisation and with developments within the organisation itself
- board away days

Community Housing Cymru **recommends** that boards undertake regular reviews of their effectiveness resulting in a plan to support continuous improvement of the effectiveness of the board. Such reviews may include regular appraisal of individual board members and the chair.

Such reviews might take into account:

- how well the board performs its role
- the effectiveness of board relationships and how it operates as a team
- the effectiveness of the governance structure
- how the board is viewed by key stakeholders, e.g. regulators, funders, local authorities, tenant groups, staff etc
- the composition of the board and the skills, competencies and contribution of its individual members
- whether the board provides enough support, scrutiny and challenge to the senior management team

Board review processes can usefully go beyond self-assessment to ensure a robust external perspective is included. Practical ways of doing this include using an external

facilitator for board review, actively seeking stakeholder feedback as part of the process or adopting a peer review approach.

Community Housing Cymru's 2009 publication ***Supporting effective governance: Good practice guidance*** provides useful practical information and guidance on board recruitment, renewal and appraisal¹⁶.

¹⁶ Available for purchase from Community Housing Cymru

2(F) Being a learning organisation

Community Housing Cymru **recommends** that:

- boards are kept up to date with developments in the regulatory and business environment
- boards receive appropriate feedback on performance, for example through analysis of complaints and feedback from tenants/residents, to inform decision-making and setting of priorities
- feedback is sought from all relevant stakeholders as part of the self assessment process
- organisations ensure that the process of self assessment is understood at all levels of the business
- the process of self assessment involves constructive challenge from the board
- the evidence gathered for self assessment is used to inform operational and strategic planning
- a clear and explicit board development plan or training programme (and individual board member development plans as appropriate) are developed, monitored and updated on a regular basis (e.g. through board review or appraisal)

2(G) Achieving value for money

G1 Managing resources and risk

Community Housing Cymru **recommends** that boards satisfy themselves that:

- there is an agreed process to identify and manage risk and an agreed means of reporting risks to the board
- appropriate, effective and robust systems of financial, people and project management are in place
- the system(s) in place to achieve continuous improvement consider value for money
- the schedule of delegated authority is appropriate, is periodically reviewed and mechanisms are in place to monitor that delegated authorities are being adhered to
- appropriate procurement arrangements are in place to deliver cost-effectiveness and efficiency

G2 Audit/the audit committee

Effective audit is essential to good governance. This goes beyond traditional financial audit and will cover all aspects of the organisation's work. Standards of performance, service delivery and complaints will all be subject to some form of audit.

Community Housing Cymru **recommends** that:

- all housing associations/community mutuals ensure that the necessary systems and procedures are established to ensure that the organisation's work is appropriately audited

and that members observe the following principles in reaction to audit:

- external auditors are independent and effective. External auditors will not normally be judged to be independent if they also provide significant non-audit services to the organisation
- proper and transparent procedures for the selection and periodic review of the appointment of external auditors are in place
- effective internal controls are demonstrated and arrangements for the internal audit function are effective
- audit arrangements and procedures are reviewed regularly, along with an appraisal of the effectiveness of the audit committee and the outcome reported to the board

Roles for the audit committee will include:

- linking consideration of risk with areas identified for internal audit scrutiny
- playing a role in ensuring that the board receives adequate and timely financial and business management reports in order to effectively scrutinise the performance of the organisation
- ensuring the board receives information about the degree of assurance provided by internal controls

G3 Sustainability

Community Housing Cymru **recommends** that its members:

- consider the sustainability of their governance structures (board composition, skills, training, renewal and succession, policies and procedures)
- provide relevant information to the board so that board members can be mindful of sustainability in their decision-making, both in terms of environmental and community sustainability

3 Ensuring sound financial management and viability

It is the board's responsibility to ensure the organisation remains financially viable, that a comprehensive assessment of the organisation's financial position and associated risks is presented to the board on a regular basis and that a sound system of internal control is in place.

Board members have ultimate responsibility for directing the affairs of their housing association/community mutual, including financial aspects.

Community Housing Cymru **recommends** members include the following as board responsibilities in relation to sound financial management:

- ensuring that the organisation is financially viable, in the short, medium and long-term, having reference to the way in which the Welsh Assembly Government assesses viability
- ensuring that the organisation is financially sustainable
- maintaining and regularly reviewing systems of financial control and financial reporting
- ensuring clear and timely financial reports are regularly received and considered
- considering the financial impacts of decisions, including financial risks
- seeking appropriate external advice at an early stage if financial difficulties become apparent

Community Housing Cymru **recommends** that relevant training and support is provided to board members to enable good understanding of:

- the financial aspects of the organisation's business or corporate plan
- budget setting
- management accounts
- statutory accounts
- feasibility and financial appraisal
- financial risk
- the requirements of lender

Appendix: Useful resources/references

Acts of Parliament

Charities Act 2006

www.opsi.gov.uk/acts/acts2006/ukpga_20060050_en_1

Companies Act 2006

www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en_1

Industrial and Provident Societies Act 2002

www.opsi.gov.uk/acts/acts2002/ukpga_20020020_en_1

Codes of Governance

Good governance - a code for the voluntary and community sector

www.acevo.org.uk/Document.Doc?id=39

Financial Reporting Council (2008) **Combined Code of Corporate Governance**

[www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008\(2\).pdf](http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf)

Governance reviews

DTI (2003) **Review of the Role and Effectiveness of non-executive directors** (Higgs Review)

www.berr.gov.uk/whatwedo/businesslaw/corp-governance/higgs-tyson/page23342.html

Good Governance Standard for Public Services (Langlands)

www.audit-commission.gov.uk/SiteCollectionDocuments/Downloads/goodgovernancestandardopm.pdf

The Seven Principles of Public Life (Nolan Principles)

www.publicappointmentscommissioner.org/Code_of_Practice/e0908a66106.html

The Walker Review Secretariat (2009) **A review of corporate governance in UK banks and other financial industry entities**

www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf

Other good practice guidance

Central Consultancy and Training **Assessing Competence: A Framework for Board Members of housing, neighbourhood and community organisations**

www.centralconsultancy.co.uk

Charity Commission (2008) **Trustee expenses and payments**

www.charitycommission.gov.uk/publications/cc11.asp

Common Purpose (2006) ***How to be an even better chair: Sensible advice about chairing in the charity, not-for-profit and public sectors***
Available to purchase from booksellers

Financial Reporting Council (2008) ***Guidance on Audit Committees***
www.frc.org.uk/corporate/auditcommittees.cfm

NCVO (2007) ***Good governance: the Chief Executive's Role***
www.ncvo-vol.org.uk/products-services/publications/good-governance-chief-executives-role

Neville Bain (2007) ***The Effective Director: building individual and board success***
Available to purchase from booksellers

Community Housing Cymru publications

CHC (2009) ***Supporting effective governance: Good practice guidance***
Guidance on board member recruitment and renewal, board member appraisal and governance infrastructure.
Available to purchase from CHC

CHC ***Board Member Handbook***
Available to purchase from CHC

CHC ***Board Member Briefing***
Issued monthly

National Housing Federation publications

National Housing Federation (2009) ***Excellence in governance: code for members***
www.housing.org.uk/Default.aspx?tabid=983

National Housing Federation (2008) ***Governance – the small print***
www.housing.org.uk/Default.aspx?tabid=983

National Housing Federation (2007) ***Achieving excellence: board appraisal***
www.housing.org.uk/Default.aspx?tabid=983

National Housing Federation (2001) ***Action for effective boards: a guide for housing organisations and their board members***
www.housing.org.uk/Default.aspx?tabid=983

Welsh Assembly Government publications

Affordable housing in Wales: an independent report to the Minister for Housing (the Essex Review, 2008)
<http://new.wales.gov.uk/topics/housingandcommunity/housing/publications/essexreview/?lang=en>

Making the Connections

A series of documents setting out the Welsh Assembly Government's approach to improving public services is online at

<http://new.wales.gov.uk/topics/improvingservices/strategy/;jsessionid=hxPxLPnLw5Xc4YZCdhVxZv9FL75ysxQCTCHmrhG5RNCdqBIQpkkh!461668963?lang=en>

Welsh Assembly Government (various) RSL Circulars

<http://new.wales.gov.uk/topics/housingandcommunity/housing/social/management/circulars/?lang=en>

Public Service Management Wales

PSMW has published a series of documents on key themes including engaged leadership. These are online at

<http://wales.gov.uk/psmwsubsite/psmw/newseventpubs/publications/sowingseeds/?lang=en>

Welsh Assembly Government (2009) ***RSL 33/09 Self assessment Guiding Principles for housing associations in Wales***

<http://new.wales.gov.uk/topics/housingandcommunity/housing/social/management/circulars/rsl3309/?lang=en>

Welsh Assembly Government (2009) ***Developing a modern regulatory framework for Housing Associations in Wales: Performance Standards 2nd Phase Consultation***

<http://new.wales.gov.uk/consultations/housingcommunity/modernframework/?lang=en>

Welsh Assembly Government (2009) ***Developing a modern regulatory framework for Housing Associations in Wales: Performance Standards 1st Phase Consultation***

<http://wales.gov.uk/docs/desh/consultation/091201housingperformanceen.pdf>

Welsh Assembly Government (2009) ***Developing a modern regulatory framework for Housing Associations in Wales Consultation paper***

<http://wales.gov.uk/docs/desh/consultation/090427housingframeworken.pdf>

Organisations

Equality and Human Rights Commission www.equalityhumanrights.com

Institute of Chartered Secretaries and Administrators – produce a range of guidance on all aspects of governance www.icsa.org.uk

Public Accounts Committee
Inquiry into Senior Management Pay – additional information from Mark Jones, Principal
Gower College & Chair Colegau Cymru

College	2010/11	2011/12	2012/13		Benefits
Bridgend College	105,000	105,000	112,000	*1	-
Cardiff & Vale College	n/a	110,000 *4	120,000		-
Barry College	82,500	-	-		-
Coleg Glan Hafren	96,162	-	-		-
Deeside College	152,000	152,000	152,000		-
Yale College	122,416	120,201	120,000		-
Coleg Ceredigion	This information to follow shortly				
Coleg Gwent	Details submitted to Chair of Committee – Meriel Singleton in an email dated 7 th March from the Clerk to the Corporation				
Coleg Sir Gar	110,278	112,530	112,530		-
Coleg Morgannwg	99,657	98,916	98,916		-
Ystrad Mynach College	124,908	124,908	124,908		Car & PRP
Coleg Llandrillo	162,356	80,072 *3	n/a		-
Coleg Menai	99,000	116,568	n/a		-
Grwp Llandrillo Menai	n/a	73,674 *3	150,000		Car allowance
Neath Port Talbot College	126,394	126,394	126,394		-
Coleg Powys	This information to follow shortly				
Gower College Swansea	145,000	145,000	150,787	*1	-
Pembrokeshire College	95,739	91,412	94,028		Car allowance
St Davids Catholic College	91,000	104,000	103,000		-
WEA North Coleg Harlech	68,000	75,000	-		-
WEA South	59,594	60,103	61,551		-
YMCA Community College	82,902	109,975 *2	56,374		-

- *1 appointment of new Principal in year resulted in a short handover period where 2 Principals were in post.
- *2 costs increased due to the provision of cover for the Head of College during a period of illness and subsequent settlement of the liability in connection with accrued holiday pay.
- *3 sums represent the cost of the previous Principal up to January 2012 and subsequently the appointment of the new Group CEO/Principal from February 2012.
- *4 Sum represents 11 months' pay only.

2.2 Location Analysis

This section assesses the impact of location on pay. The survey uses up to fourteen College income groups and seven geographical areas.

Area	Number of Colleges	Definition
London	49	Greater London area
South	101	South East and South West areas plus Bucks., Beds., Herts. and Essex
Midlands	80	West Midlands and East Midlands areas plus Norfolk, Suffolk and Cambridgeshire
North	103	Northern, North West and Yorkshire & Humberside areas
Wales	13	All Colleges in Wales
Scotland	1	All Colleges in Scotland
N. Ireland	3	All Colleges in Northern Ireland

Table 4

Analysis of Basic Salary Level 1 - Principal

Wales

College Income	Sample	LD	LQ	Base Salary M	UQ	UD
up to £25m	4			73,750		
£25m to £48m	6		113,148	122,500	134,763	
£48m and over	4			138,829		



Adran yr Economi, Gwyddoniaeth a Thrafnidiaeth
Department for Economy, Science and Transport
Cyfarwyddwr Cyffredinol • Director General

Llywodraeth Cymru
Welsh Government

Darren Millar AM
Chair
Public Accounts Committee

23 May 2014

Dear Mr Millar

Public Accounts Committee – Intra-Wales – Cardiff to Anglesey – Air Service

I am writing to follow up on your letter of 2 May requesting further information on the North South Air Service.

I have enclosed a document which attempts to do this as fully as possible. Please let me know if you require any further information.

Yours sincerely

James Price



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**Welsh Government response to the letter from the
Public Accounts Committee, dated 2 May 2014.**

Following the evidence provided at the Public Accounts Committee on 25 March 2014, the Public Accounts Committee raised a number of queries. The Welsh Government provided a response to each query raised in a letter dated 23 April 2014. The Committee is seeking further information and clarification from the Welsh Government. This document provides responses to each query raised and seeks to provide the clarification required.

1. The Committee sought further explanation about the changes in state aid rules affecting the PSO subsidy and the additional flexibility that these changes may provide should the Welsh Government decide to continue its subsidy of a North/South Wales Air Service beyond December 2014. Your response does not articulate the specific changes in the rules, nor does it make clear the additional flexibility that the new rules may offer for any future Air Service contract. We request further detail on these matters;

Welsh Government Response:

The European Commission's 2014 Aviation Guidelines provide further clarification to state aid rules for PSO's when compared to the 2005 Guidelines. This has given greater certainty and therefore fewer constraints in the Welsh Government's approach to the planning of a potential future service. Should the Welsh Government continue to support the Public Service Obligation Wales Intra Air Service, this will aid any tender process. Bidders will be required to provide innovative responses to explore additional routes and consider the reduction of current contract downtime.

Greater flexibility is now also available in other areas, such as operating aid. "Operating aid" means funding to cover costs that a company could expect to pay in the normal course of business, such as rates, rent and utilities bills.

For example, hypothetically, a new PSO Cardiff–Anglesey return service could run twice daily (at the beginning and close of each business day, Monday-Friday). With this service, the aircraft would sit stationary throughout the day incurring hours of continuous downtime. To utilise the aircraft and reduce downtime, an additional, commercial service could be offered; for example, Cardiff-Paris - taking advantage this downtime with the assistance of operating aid.

2. The Committee requested a detailed breakdown of the data the Welsh Government is gathering to inform its decision on the future of the Air Service if not specified by, or separate to, the Terms of Reference for the work being undertaken by ARUP. The Committee's request specified a number of areas on which data might be collected. The response states that these are identified in the Terms of Reference for the Review of the Intra Wales PSO Air Service being undertaken by ARUP as attached at Annex B of the response. The Committee did not feel that the detail contained in this Annex answered our request sufficiently. While it set out the key areas being considered by ARUP, the information provided in the Annex did not specifically state what data the Welsh Government is gathering to inform its decision on the future of the Air Service. We request further detail, including confirmation of whether the Welsh Government is gathering the data necessary to address the specific points raised in our original letter;

Welsh Government Response:

ARUP is undertaking a review to provide advice to Welsh Government on the best solution for determining a future air service for Wales. We intend this research will include:

- identifying the role that the air service could play in the Welsh Government's strategy for Cardiff airport
- identifying synergies between the air service and other developments (such as the Energy Island)
- a better understanding of the journey purposes of users of the service and their overall catchment area
- a better understanding of service users, both private and public sector, through analysis of demographic data (where the information is available)
- identifying the perceived advantages of the service against other modes of travel
- exploring options for alternative commercial approaches to the air service in order to establish the likely subsidy requirement for continuing services beyond 2014
- undertaking primary research to establish the importance that businesses place on the air service
- to understand whether any negative economic impacts could be expected in the event that the service is removed
- exploring different, viable, route options and connectivity

A benchmarking exercise against PSOs elsewhere in the UK/Ireland has already been undertaken and forms part of the initial review previously undertaken by ARUP.

3. The Committee asked for confirmation of the timetable by which the Welsh Government expects to determine the future of the Air Service, including the timescale for the possible re-tendering exercise and the contingency arrangements should the tendering process fail to identify a suitable provider.

Regarding the timetable, the Committee would welcome confirmation of: when the Welsh Government expects to make a decision on whether to go out to tender for a new Air Service contract; when any subsequent tender process is likely to commence; and when the tendering process would be completed (assuming that there is a need to allow sufficient time in advance of the expiry of the current contract in the event of a change in contractor).

The Committee would also welcome confirmation of the role that the second phase of work being undertaken by ARUP will play in the Welsh Government's decision on whether to go out for tender for a new Air Service contract. The 'six-month' tendering process referred to in your previous response, combined with the expectation that the ARUP work will be completed in July 2014, suggest that the ARUP work will not be completed in time to fully inform that decision.

Your response appears to refer to how contingency planning requirements would be built into any new Air Service contract. The Committee was concerned about the contingency arrangements should any tendering process fail to identify a suitable provider. In such circumstances, we welcome confirmation of the scope of any action that the Welsh Government might be able to take to continue the service in the short-term, and information on how you expect to be able to secure value for money from such arrangements. We note that the Welsh Government found itself in the same position in early 2010. The Auditor General's memorandum indicates that the Welsh Government received legal advice at that time indicating that a contract extension would have breached procurement regulations. Legal advice also questioned whether the 'emergency procedure' provisions within the PSO rules could be satisfied and noted that there were various risks in taking forward an interim contract;

Welsh Government Response:

An early phase of ARUP's work into the review of the air service will be used to form advice to Ministers on the future of an air service in Wales. The full report will be provided by ARUP to Welsh Government by July.

In line with timescales for a full OJEU tendering exercise, the Welsh Government, if it decides to procure a new air service, would ensure any potential procurement exercise is underway by the end of the summer. The existing contract comes to an end on 9 December.

The Welsh Government currently anticipates sufficient market interest to potentially hold a procurement exercise for a future air service in Wales. At this stage, we envisage any potential procurement process would be completed in time for a new contractor to provide a service following the expiry of the current contract.

4. The Committee asked for a description of any action taken by the Welsh Government to promote the Air Service or to encourage additional marketing activity by the operators during the current contract term and the extent of influence that the Welsh Government has over the pricing model.

The response outlines the budget allocated within the current contract for marketing activity and what the current provider is doing. However, we would still welcome clarification about the level of influence the Welsh Government has over the pricing model. As noted previously, the Committee raised this point in the context of the different business model operated by Manx2/Citywing compared with Highland Airways that you put forward as one reason for the reduction in passenger numbers. We also note that phase 2 of the ARUP work is intended to include a 'review of fares policy'.

Welsh Government Response:

The ARUP review will include looking into a revised fares strategy, including the possibility of removing the maximum fare cap, to support maximising passenger numbers while balancing the revenue risk of the Welsh Government. It is at the service provider's commercial discretion to offer fares at or below the maximum ticket price. It should be noted that Citywing operates a different commercial model to Highland Airways, with a greater focus on a reduced revenue risk.

5. Finally, in addition to these points the Committee noted the reference in Annex A to your response to the recently opened investigation by the European Commission into compensation for Sardinian Airports.

Your response indicated that the outcome of this case should provide further guidance on what can and can't be funded by way of a service of general economic interest. The Committee would welcome confirmation of whether the Welsh Government has any indication of the likely timetable for the completion of that investigation. In addition, the Committee requests details of any contingency plans by the Welsh Government to take into account the outcome of this investigation and the impact this might have on any future Air Service contract;

Welsh Government Response:

The Welsh Government maintains contact with the EC and looks forward to receiving the report on the investigation into compensation for Sardinian Airports. At this time, the Welsh Government has received no indication as to when we can expect this decision or what it will say.

We suggest that the Public Accounts Committee might want to consider contacting the EC directly to obtain this information.

The European Commission's investigation is being undertaken completely independently of the Welsh Government, and as such it is almost impossible for the Welsh Government to gather a contingency plan and is unable to make assumptions when the content of the report is entirely unknown.