



Northern Ireland Audit Office

Campsie Office Accommodation



Synergy e-Business Incubator (SeBI)



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
24 March 2010



Northern Ireland Audit Office

Report by the Comptroller and Auditor General for Northern Ireland

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K J Donnelly
Comptroller and Auditor General

Northern Ireland Audit Office
24 March 2010

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Abbreviations

CPD	Central Procurement Directorate
DARD	Department of Agriculture and Rural Development
DETI	Department of Enterprise, Trade and Investment
DFP	Department of Finance and Personnel
DSO	Departmental Solicitors Office
IDB	Industrial Development Board
IPDS	Industrial Property Development Scheme
LBB	Land and Buildings Branch
LEDU	Local Enterprise Development Unit
NIAO	Northern Ireland Audit Office
OAB	Office Accommodation Branch
PDA	Property Development Agreement
PDS	Property Development Schemes
PSU	Property Solutions Unit
SMT	Senior Management Team
VLA	Valuation and Lands Agency
VLO	Valuation and Lands Office

Introduction and background

1. Providing land and buildings in suitable locations has long been regarded as an important aspect of government attempts to promote economic development in Northern Ireland. In this respect, the former Industrial Development Board (IDB) which was established in 1982, had responsibility for acquiring and managing land and property for use by potential indigenous or overseas investors and this was managed by its Land and Buildings Branch (LBB). When IDB became part of Invest NI in April 2002, the Property Solutions Unit (PSU) assumed responsibility for this function. Invest NI is a non-departmental public body funded by the Department of Enterprise, Trade and Investment (DETI).
 2. In 1989, two developers approached IDB with proposals to establish a large new office based business park within a part of the former Courtaulds site at Campsie. Following negotiations which resulted in the size of the development being scaled down, IDB entered into agreements in November 1991 and January 1992 under its Industrial Property Development Scheme (IPDS) with the developers for two 10,000 square feet units located at the site. IDB was seeking to secure the two units for occupation by potential client investors and the developers were required to hold these for an initial four year 'control period' for occupation by a qualifying customer, during which IDB paid substantially reduced rent. As part of the IPDS agreements, the developers were each paid grants of £112,500 by IDB to assist with construction costs.
 3. Although IDB was granted 25 year leases under the IPDS, the agreements provided it with an 'option to break' at the end of the four year control period; in effect to discharge itself from the leases with no further financial commitment if the prospects of finding qualifying tenants appeared remote. This was an important clause, designed to protect IDB's financial interests. Following the end of the control period, rent for each unit would increase substantially to £45,000 per annum for the remaining 21 year lease period. This meant that IDB's total financial commitment for the units would amount to up to £2,407,500, if a tenant could not be found.
 4. Both units remained unoccupied throughout the 'control period', and DETI told us that there was no demand for the units. Despite this, IDB did not exercise its 'option to break' after the initial four years, meaning that it was committed to the full 25 year leases for both buildings. IDB and latterly Invest NI have subsequently been unable to let either unit and client interest has remained disappointing. Significant issues also arose over the failure by the developers to meet their contractual obligation to maintain the buildings in a satisfactory condition. Although IDB was initially aware that the units were in a poor condition in 1998, more decisive action to ensure that the developers complied with their maintenance obligations was not commenced by Invest NI until mid-2005, following a major restructuring of its Property Solutions Unit (PSU) which had commenced in May 2004. By this time one of the buildings was in a very poor state of repair, and the other had deteriorated to a lesser extent through vandalism.
-

5. This more robust action ultimately resulted in Invest NI negotiating a 'surrender premium' for one of the buildings (Unit B), whereby it paid £180,000 to the developer in return for being released from its rental obligations from January 2008 (over nine years early). This saved Invest NI up to £371,250, but total costs of £832,500 were incurred for a building which was never occupied. As part of subsequent negotiations with the developer over Unit A, Invest NI paid rent, which it had withheld, of almost £88,000 in December 2009. Invest NI secured commitments from the developer including undertakings to fit the unit out, and to maintain and secure it on an ongoing basis. In February 2010, Invest NI also reached an agreement "in principle" with the developer of Unit A for the surrender of this lease. If this is formally agreed, this will result in savings of up to £267,864. This means that total savings of up to £639,114 will have been achieved through the negotiation process. This consists of £414,114 saved in rental charges, and £225,000 potentially saved in further grants should Invest NI have opted to have the units fitted out. However, overall costs incurred by Invest NI for both buildings are likely to be £1,768,386.

Figure 1 provides full cost details.

Scope of NIAO review

6. This short report seeks to establish what lessons can be learned from the Campsie experience. It focuses on:
- IDB's rationale for leasing the units, and whether this was supported by a strategic need, and was subject to appropriate appraisal and approval processes (**paragraphs 8 to 15**);
 - why IDB did not break from the leases after the initial four years (**paragraphs 16 to 23**);
 - the steps taken by IDB and Invest NI to let the units or surrender the leases, and the reasons why there was little demand for them (**paragraphs 24 to 35**);
 - the latter action taken by Invest NI to address the problems experienced, and protect its commercial interests (**paragraphs 36 to 45**); and
 - whether the Campsie leasing agreements delivered value for money, and whether Invest NI's current arrangements for

Figure 1: Actual and Potential Costs of Leasing Campsie Units

Costs incurred to May 2010*	Unit A - £	Unit B- £	Total- £
Rent	598,386	540,000	1,138,386
IPDS grant	112,500	112,500	225,000
Surrender premium	225,000	180,000	405,000
Potential total costs	935,886	832,500	1,768,386

*This assumes that the surrender of Unit A is formally completed.

Source: DETI/Invest NI

the provision of property for economic development purposes protect it from a recurrence of the problems experienced with the Campsie leases (**paragraphs 46 to 52**).

NIAO conclusion

7. Overall, NIAO concludes that:

- IDB assessed the project in light of advice from the Valuation and Lands Office (VLO) and the Departmental Solicitors Office (DSO). Whilst VLO expressed concerns on several occasions about the scale of the project and demand for it, in view of its policy objective to stimulate development in areas where deprivation and market failure existed, IDB decided to proceed with leasing the units; and
- the failure by IDB to exercise its option to break from the leases in 1996 had significant consequences, and in the absence of tenants for the units, effectively committed IDB, and subsequently Invest NI, to future rental obligations of up to £1,890,000. Thus it is apparent that this intervention has not delivered value for money.

Invest NI told us that apart from Campsie only one other case in the early 1990's had involved the use of IPDS, and as this property was assigned to a client company in August 1992, IDB had no ongoing liabilities. Invest NI also told us that IDB's Property Development Agreements (PDA's), the Local Enterprise Development Unit's (LEDU's) Property Development Schemes

(PDS's) and Invest NI's property assistance arrangements did not make use of leases. These arrangements for property intervention mean that, apart from this project, there has been no opportunity since the early 1990's for IDB or Invest NI to miss a break clause in a lease.

IDB's rationale for leasing the Campsie units

8. Historically, IDB sought to ensure that it had a supply of land and accommodation across Northern Ireland for immediate development and occupation by potential client investors. This was mainly delivered throughout the 1980s by its Advanced Factory programme. In the late 1980s and early 1990s, IDB's provision policy shifted to support on a speculative basis, whereby the private sector was encouraged to develop factories, industrial units and office buildings.
9. In September 1989, IDB entered into discussions with developers to assess the potential for providing office type accommodation in the Campsie area. IDB viewed this location as a priority at the time, particularly as it was within an Enterprise Zone, and because it wished to secure suitable property for potential inward investment for 'back office jobs'. An appraisal document produced on behalf of the developers in November 1989 provided early cost estimates for a comprehensive business park development at Campsie, which involved 60,000 square feet of office accommodation.
10. Having reviewed this appraisal in November 1989, VLO considered that

there was insufficient demand to justify a 60,000 square feet project. Indeed, VLO expressed “severe reservations” over potential demand for 20,000 to 30,000 square feet of office accommodation at Campsie, and ultimately considered that a 20,000 square feet project was the maximum to which IDB should commit financial assistance. On this basis, IDB subsequently reached an agreement with the developers to restrict the project to this scale.

11. In line with recognised procedures at the time, the developers submitted an indicative business proposal to IDB in January 1990 which provided more detailed estimates of project costs, and notified IDB of subsequent changes to costs as the project evolved. VLO, having carried out an assessment of the accuracy of the developers’ calculations, made its final recommendation on the extent of eligible costs and the degree of financial assistance which IDB should offer towards the project in June 1991. It was against this background that IDB entered into agreements under its Industrial Property Development Scheme (IPDS) with the developers in November 1991 and January 1992, for the two 10,000 square feet units located within Campsie Business Park.
12. Whilst our review of the appraisal process found that VLO initially endorsed the concept of a private sector initiative to create a business park in Campsie, we also found evidence that it persistently raised concerns about aspects of the proposed project as it evolved, particularly in relation to the unit’s specific location within the business park and the likely demand for the accommodation. As **paragraph 10** indicated, IDB restricted its support for the project to 20,000 square feet following VLO concerns over the initial plans for a 60,000 square feet development. It is also apparent that VLO had concerns about demand for a 20,000 square feet project - in May 1991, it twice queried whether it should be further restricted to a single 10,000 square feet unit. VLO considered that a pilot exercise approach could be used to establish the type and extent of demand, and minimise the amount of public money spent on the project. Having assessed the advice from VLO, as well as from DSO, IDB decided to proceed with the 20,000 square feet project. Invest NI told us this had been a considered opinion, influenced both by the advice received and the policy objective of seeking to develop areas where there was market failure and deprivation.
13. Invest NI also told us that it would not have been unusual for VLO to have raised concerns over the proposed location of many of its property solutions at the time. This was because a key objective behind these was to attempt to stimulate economic development in certain areas of Northern Ireland (such as Campsie), through incentivising developers to provide property solutions in areas where there was little or no demand for industrial or office accommodation. It was ultimately on this basis that IDB opted to enter into the agreements with the developers for the Campsie project.
14. This decision committed IDB to initial expenditure of £292,500 (i.e. IPDS grant

of £112,500 for each unit to assist with construction costs, and total rent payments of £33,750 for each unit in respect of the four year control period). However, a more significant matter in terms of costs incurred was the need for IDB to reach a considered decision on whether it should break from the leases at the end of the control period, if it had been unsuccessful in assigning the units to client companies. This was because if it did not do so on the precise day the control period expired, and was unable to secure tenants, it would effectively be liable to future rental commitments of up to £1,890,000 over the full lease period. The next section of this report addresses this issue.

15. VLO had expressed concerns on several occasions about the scale of the project and market demand in this area where there was acute market failure. We recognise that IDB had a key objective to stimulate economic development in locations where clear market failure existed and that VLO advice was unsurprising. Contemporary documents show that VLO advice was considered during the course of the meetings and IDB, as it was entitled to, decided to proceed with supporting the development of the units. VLO then negotiated the IPDS terms with the developer. When investment decisions are being taken, all professional advice obtained should be carefully considered. If this advice is not acted upon, contemporary documentation should be available to show reasons for this decision.

IDB did not exercise an available option to break from the leasing agreements after the initial four years

16. When entering into long term property leases, inserting an option to break (**see paragraph 3**) is not unusual, as this enables lessees to reconsider the merits and costs of fulfilling the full term of long term agreements. As such, IDB built clauses into the leases for the Campsie units which enabled it to 'break' when the four year control period had expired. These were clearly designed to protect IDB's interests as they enabled it, if the prospects for finding qualifying tenants appeared remote, to discharge itself from the leases with no further commitment before rents increased substantially (from between £1 and £16,875¹ to £45,000 per annum per unit) for the remaining 21 year period. However, as **paragraph 14** indicated, the terms of the leases required IDB to be pro-active in exercising the option to break on the precise day on which the control period expired.
17. Our examination indicated that there was very little serious demand in the Campsie units from potential IDB client investors during the control period. However despite this, IDB did not exercise the available option to break from the leases at the end of the control period (in August and September 1996).
18. Available records indicate that IDB had intended to break from the leases, but that the matter was simply overlooked at the time. For example, an internal IDB file note dated May 1991 noted that "IDB would break from the leases after an initial

1 Annual rent for each unit was £1 for two years, and £16,875 for the other two years during the control period.



four-year period if no assignment could be made". Another internal memorandum dated December 1995 highlighted specifically that the control period for the units would expire in August and September 1996. Furthermore, in July 1998, the Valuation and Lands Agency (VLA) stated in correspondence to IDB that "the intention of IDB to terminate all interest in the units after four years was clearly known to both sides at the outset".

19. It is important that:

- communications systems within government bodies operate effectively. More specifically, these should be designed to ensure that important deadlines related to key operational decisions are clearly flagged up and acted on. In this instance, this would have been served by a "brought forward" system which would have alerted the Head of IDB's Land and Buildings Branch (LBB) that the deadline for these break clauses was imminent; and

- clauses which protect the interests of government bodies, such as the option to break which was available to IDB within these leases, are fully utilised when it is clear that this would be in the best interests of the parties concerned.

20. DETI told us that although Invest NI does not currently have any properties which have 'break points' in their leases, it does operate a "brought forward" system in relation to rent reviews on the various properties which it rents to clients.

21. The failure to break had significant consequences and, in the absence of tenants for the units, it effectively committed IDB and subsequently Invest NI, to future rental obligations of up to £1,890,000 (£45,000 per annum for each building – the rent applicable to fitted out units). However, the buildings had only been constructed to a 'shell' finish, i.e. with no ceilings, floors, facilities or services. Under the IPDS agreements, the onus was on the developers to fit the units out to an initial defined specification, and to any tenants' specific requirements thereafter. Whilst fit-out appears to have been deferred until tenants could be found, the obligation for the developers to complete this has remained throughout the lease period. The absence of tenants has meant that IDB and Invest NI have not taken steps to require the developers to complete the fit-out, and the units have remained in their shell condition. The leases provide for the specific rental of £45,000 per annum to be paid, and there is no legal mechanism for seeking a reduction in this rate.

22. Although the failure to break from the leases appears to have been attributable to an oversight which ultimately proved very costly for IDB, we found no evidence that any internal enquiry was undertaken to determine the circumstances surrounding the events at the time. Whilst it is apparent that IDB senior management was aware of the situation, through a position paper (November 1997) which also outlined options for resolving the difficulties, we found no evidence of an internal investigation which sought to determine:

- the precise circumstances behind the failure to exercise the break;
- whether any individuals within the organisation were culpable of negligence or possible misconduct, and whether any disciplinary action should have been considered; and
- whether there were any significant system failures.

23. When an unexplained sequence of events ultimately results in a significant loss to the public purse, a robust examination should be undertaken. Key findings should be reported to senior officials and the management board, and lessons to be learned should be disseminated throughout the organisation.

The steps taken by IDB and Invest NI to let the units or surrender the leases, and the reasons why there was little demand for them

24. Whilst the 'control period' for the leases expired in August and September 1996, we found no documentary evidence of IDB taking action to reassess its position until November 1997 (**see paragraph 22**), when it sought legal advice on the matter. With this confirming that it was effectively locked into the leases for the full 25 year period, IDB concluded that it should make greater efforts to market the units, including appointing an agent for this purpose. IDB also identified the option of negotiating the surrender of the leases² with the developers. However, following advice from Valuation and Lands Agency (VLA - the successor organisation to VLO) in March 1998 that the developers would demand a very high surrender premium, IDB decided not to pursue this option any further at this stage.
25. In August 1998, an IDB official and VLA valuer visited the developers to discuss the situation and assess whether it would be possible to retrospectively break from the leases. However, both developers were adamant that the leases remained valid for the full 25 year period, and further legal advice in September 1998 reaffirmed this. Consequently, IDB identified that it had three main options to resolve the matter:
- retain the leases;
 - market the leases on an open basis, including non IDB client companies; or
 - re-negotiate the surrender of the leases.
26. IDB identified significant drawbacks with the first two options:
- if it opted to retain the leases, the prospect of an early assignment to a qualifying client was slight, meaning that it would likely be left paying rent in the long term, for property which remained unoccupied; and
 - marketing the units on an open basis would require resolution of a number of issues with the developers, including:
 - an outstanding rent review;
 - issues over the poor maintenance condition of the units; and
 - resolving the issue of 'fitting out' the units.
27. In view of these problems, IDB decided that it should attempt to re-negotiate the surrender of the leases with the developers. Although this option had been considered and discounted earlier in 1998 (**see paragraph 24**), IDB now considered that this *"would at least offer a clean break, and a final answer to all aspects of the overall situation"*. However, as had been anticipated by VLA, subsequent negotiations with one of the developers resulted in a refusal to surrender for anything short of payment of rent for the full lease term and IDB therefore did not pursue this option further. Consequently, with its choices clearly narrowing, IDB concluded that it should proceed with increasing its efforts to market the units.

2 Surrender of a lease involves the lessee making a one-off payment in return for being released early from the full lease term.

28. Whilst IDB had identified the merits of appointing an agent to market the units in March 1998, it did not formally instruct VLA to take steps to proceed with this until June 1999. The appointment only took effect from January 2001. The documentation reviewed suggested that this delay was due, in part, to the attempts being made in the interim to negotiate the surrender of the leases and also with issues associated with identifying a suitable marketing strategy and rental value for the units.
29. In July 1998 IDB became aware that the units were in an unsatisfactory state of repair. Whilst it obtained legal advice at this time from the Departmental Solicitors Office (DSO), which indicated that, because the units remained vacant, the developers were in breach of maintenance clauses within the IPDS agreements, the condition of the units continued to deteriorate. By March 1999, IDB's regional manager for the Campsie area considered that these were *"not in a fit state to be shown to potential investors"*, and recommended that *"repairs should be completed by the landlords as soon as possible"*.
30. Although IDB documentation from April 1999 suggests that a report outlining the repairs necessary to bring the units back to a reasonable state had been commissioned, there are no further records to indicate whether action was taken at this stage to enforce the developers to comply with their maintenance obligations.
31. The absence of subsequent documentation until 2005 means that it is not possible to assess the extent to which the units subsequently fell into disrepair, or whether the developers were carrying out any repair or maintenance work. Invest NI told us that they have no evidence to indicate that IDB undertook any repair work, apart from emergency repairs to board the units up following storms in December 1998. No repairs were undertaken by Invest NI. Consequently, whilst the units continued to be available for inspection by potential tenants between 1998 and 2005, the evidence suggests that they were in a poor condition, at least sporadically and possibly consistently, throughout this period.
32. In addition to the lack of documentation on the maintenance issue, we found virtually no records between April 1999 and early 2001 relating to further action taken on the general issues which had arisen with the Campsie units. In 2001, the Department of Agriculture and Rural Development (DARD) expressed significant interest in leasing one of the units. In anticipation of being able to assign this, and to assess the potential for surrendering the other lease, IDB again sought to determine whether either developer would be willing to agree a surrender premium. These efforts proved unsuccessful, as one developer was only willing to settle for an unacceptably high figure (£650,000 compared to the £225,000 IDB offer), and the other rejected this option outright.
33. Negotiations between IDB (Invest NI from April 2002) and DARD on the possible assignment continued throughout 2002. However, the likely costs of fitting-out the unit to meet DARD's specific tenant requirements (estimated at between £750,000 and £830,000 in September 2001³), and the

³ Whilst these were cost estimates for fit-out of the unit, these were never subject to detailed scrutiny and negotiation between DARD and the developer, and the actual cost to DARD may have been lower if the assignment had gone ahead.



lack of detailed examination of the proposal and subsequent negotiation between DARD, Invest NI and the developer over the fitting-out of the unit, emerged as a stumbling block. Against this background, and with a view to developing a better marketing strategy for both units, Invest NI completed a draft Business Plan in January 2003 which assessed the costs of carrying out improvements to the units. This estimated expenditure of £668,000 to fully fit-out one unit, partially fit-out the other, and complete external improvements. Invest NI told us that it subsequently decided not to proceed with this option.

34. In March 2003, the Department of Finance and Personnel's (DFP) Office Accommodation Branch (OAB) contacted Invest NI in relation to the possible assignment to DARD. OAB expressed concern that Invest NI had not supplied likely fit-out costs, and the contribution it would be willing to make towards these, and suggested a lack of impetus on the part of Invest NI in moving the matter forward. We were unable to find any additional documentation relating to DARD's interest in the unit and can only conclude that it decided not to pursue the matter any further.

35. As **paragraph 28** indicated, an agent was initially appointed to market the units in January 2001. By January 2002, this had produced no interest from prospective tenants and IDB concluded that a factor behind this may have been that the agent was located in Belfast. Consequently, in July 2002 Invest NI approached an agent based in the Campsie area, with a view to carrying out a locally based marketing campaign. However, this was deferred in light of the ongoing DARD interest in one of the units, and the local agent was not appointed until March 2003. This was over six years after the end of the control period, when the onus to find tenants for the units had transferred to IDB. Furthermore, despite the appointment of the two agents, documentation held by Invest NI indicates that neither unit was aggressively marketed between late 1998 and 2005. Given the issues which had arisen over the marketing of the units, and the fact that they had fallen into disrepair, it is unsurprising that there continued to be very little serious interest in the units by prospective occupants (other than DARD).

Invest NI took more decisive action to address the problems experienced, and protect their commercial interests

36. Following the establishment of Invest NI in April 2002, an independent strategic review of the organisation's Property Solutions Unit (PSU) was undertaken. Consultants were engaged to undertake this review, which involved a wide range of participants including officials from Invest NI, Central Procurement Directorate (CPD) and VLA. Completed in September 2004, it outlined

a series of recommendations on the future role of property interventions for supporting economic development in Northern Ireland. To assist the implementation of these, a new Senior Management Team (SMT) was appointed in PSU in September 2004.

37. PSU sought to adopt a more robust approach to the Campsie situation, and obtained legal advice in July 2005 on the feasibility of taking further action in dealings with the developers, including withholding rent to make them comply with their maintenance obligations. This advice confirmed that Invest NI had no requirement to maintain the units.

38. In December 2005, PSU again attempted to establish whether the developers would consider surrendering the leases. Although contact was made with both developers, only one would enter into discussions and he continued to express little enthusiasm for this option. By this stage, an internal Invest NI investigation indicated that the units were in a very poor state of repair and concluded that *"under the present conditions, we cannot even consider showing these to our clients, never mind paying rent for them"*.

39. Invest NI concluded that if it was to continue paying rent it should ensure that the units were fit for purpose and presentable for marketing, by enforcing compliance with the landlords' maintenance obligations. Invest NI considered that such action would require the landlords *"rather than sitting back and taking £45,000 each pa for doing nothing but letting these properties fall into disrepair and dereliction"*, to take action to address the maintenance issue.

40. As part of the more robust approach to address the situation, Invest NI commissioned DFP in early 2006 to prepare conditions reports⁴ for both properties. Completed in September 2006, these reports listed the work required by the landlords to bring the units to a full state of repair. This enabled Invest NI to issue notices to each developer, outlining repairs required to restore both units to a fully marketable condition and to withhold rent from the developers from July 2007 until the necessary maintenance was undertaken. Invest NI subsequently undertook monthly inspections to monitor the action taken to carry out the necessary repairs and issued monthly reports to the developers which listed the work done, together with items outstanding.
41. This course of action delivered some positive benefits. By November 2007, one of the units had been brought back to full repair, and Invest NI recommenced paying rent. During the inspection process for this unit, Invest NI again raised the possibility of surrendering the lease with the developer, who undertook to consider the option. Although the developer subsequently indicated his willingness to surrender for a premium of £200,000, Invest NI succeeded in negotiating a final premium of £180,000 in return for being released from its rental obligations from January 2008 (the lease had been due to run until September 2017).
42. The deal negotiated by Invest NI for this unit means that it has achieved a net saving of up to £371,250 in comparison to paying rent for the full 25 year lease period (£258,750 in rental payments and £112,500 of grant which may have been incurred had Invest NI required the developer to fit the unit out). Increased costs which may have arisen from a forthcoming rent review, scheduled for 2012, have also been avoided. However, when IPDS grant, rent paid during the lifetime of the lease and the surrender premium is taken into account, the failure to break from this lease in September 1996 has resulted in total expenditure of £832,500 being incurred for this unit, approximately £686,250 (82 per cent) of which was paid after the options to break were not exercised by IDB in 1996. Furthermore, the amount paid in terms of rent and surrender premium alone effectively means that rental costs were incurred for over 19 years of the 25 year lease, for a building which was never occupied. Invest NI told us that notwithstanding the surrender of the lease, the vacant unit is available for potential economic development projects in an area where accommodation of this type is minimal.
43. The remaining unit was adjudged to have been brought back to full repair by the developer in January 2008. As part of subsequent negotiations with the developer, Invest NI paid rent which it had withheld of almost £88,000 in December 2009. However, Invest NI also secured a number of commitments from the developer, including undertakings to provide a proposal for fitting out the unit, and to maintain and secure it on an ongoing basis. In February 2010, Invest NI reached an agreement “in principle” with the developer to surrender this unit, in return for payment of five years rent (£225,000). If formally agreed, this will result in savings of up to £267,864 (£155,364 in rental

4 A written report, supported with photographs, which outlines the condition of a building or adjacent infrastructure.

payments and £112,500 of potential fit out grant). In total, savings of up to £639,114 may be achieved through the negotiation process (£414,114 of rental costs actually saved, and £225,000 of grant which would have been payable had Invest NI required the developers to fit the units out).

44. We acknowledge that the newly appointed PSU team inherited a complex and difficult situation in respect of the Campsie units, and that its options for improving Invest NI's position were limited. It is therefore encouraging to see that the more decisive course of action taken since mid-2005 has yielded positive benefits. However, the evidence suggests that the landlords did not carry out the necessary maintenance and that the units were in a state of disrepair on various occasions for a period spanning over nine years, but that rent was only withheld for periods of five and seven months respectively. In our view, more effective, earlier action to enforce the developers to fulfil their maintenance obligations would at least have resulted in the units being made fit for purpose, and may also have encouraged the developers to consider surrendering the leases at an earlier stage. Furthermore, the absence of any documentation between April 1999 and June 2005 relating to the maintenance of the units is particularly concerning, as this makes it impossible to assess if any action was being taken to address the problems which had arisen. The evidence suggests that there was little action during this period regarding the maintenance of the units.

45. When government bodies are faced with ongoing problems, such as those which were apparent in this case, they should re-assess their options as matters progress. Where necessary, robust commercial practices should be applied on a timely basis to ensure that contractual obligations are met and that the best value for money is achieved for public funds. It is also essential that a full audit trail to support all key decisions is maintained.

The poor value for money delivered from the Campsie leases, and Invest NI's revised arrangements for providing property for economic development purposes

46. The negotiations undertaken by Invest NI with the developers have helped reduce the costs associated with this project, which was aimed at stimulating economic development in an area where there was acute market failure.
47. However, it is apparent that the leasing agreements for the Campsie units have not delivered value for money. Potentially, up to £1,768,386 of expenditure will have been incurred for units which have never been occupied, with no new jobs or business opportunities created. In our view, there are a number of reasons which explain the failure to let the units. Most significantly:
- the location of the office units in an area where there was acute market failure heightened the risk of them not being let;



- the lack of action by the developers to maintain the units, and by IDB to address the issue, which resulted in the units' general state of disrepair between mid 1998 and late 2007; and
- the lack of incentive for the developers to secure tenants once the control period had expired, in that the developers were guaranteed full payment of rent even if the units remained vacant.

48. In conclusion, the central issue which emerged from our examination was **the failure to break from the leases at the end of the control period**. This was fundamental to almost all the problems which were

subsequently encountered, and ultimately resulted in IDB and Invest NI being locked into 21 year leasing agreements, and incurring significant expenditure, for no tangible return. In addition to the expenditure on the leases, the efforts to resolve the matter resulted in administrative costs being incurred across a range of government bodies. It is particularly concerning that the available evidence suggests that the break was not exercised due to the matter simply being overlooked at the time by IDB.

49. In addition to the failure to break from the leases, it is apparent that VLO expressed concerns on several occasions about the scale of the project and market demand for

it in this area. However, Invest NI told us that IDB opted to proceed with it, having reached a considered decision which took account of advice from both VLO and DSO and the policy objective to develop property solutions in areas where acute market failure existed (**see paragraph 13**). We acknowledge that the evidence suggests that IDB had intended to break from the leases. In these circumstances, the expenditure committed to the project up to the 'break point' (approximately £292,500) would have been considerably lower. In view of IDB's role in trying to stimulate areas where market failure existed, this may have been considered as a worthwhile attempt to create demand.

50. Whilst the developers had initially envisaged a 60,000 square feet development (**see paragraph 10**), IDB had sought to address VLO concerns over the scale of the project and opted for a balanced solution of 20,000 square feet (**see paragraph 10**). However, project costs could also have been minimised further at this early stage had IDB acted on VLO's suggestion to restrict the project to a single 10,000 square feet unit (**see paragraph 12**). Although the failure to exercise the option to break from the leases in 1996 could not have been foreseen at this stage, a pilot exercise approach would have acted to significantly minimise the costs which were subsequently incurred.
51. Following the major review of Invest NI's property solutions, and the appointment of the new SMT in PSU (**see paragraph 36**), Invest NI introduced new client based Property Assistance arrangements in

September 2005. These involve it working directly with client companies (as opposed to developers) to identify appropriate property solutions. Financial assistance for client owned property construction solutions is provided in the form of a capital grant where clients' business plans indicate a funding gap, and clients are able to access technical and professional advice and expertise within Invest NI to assist the development and completion of projects. Invest NI told us that this expenditure is subject to a rigorous appraisal and approval process. Client companies are required to submit outline and full project proposals, and a business case which is subject to scrutiny and approval through both Invest NI's Casework process and, where appropriate, through DFP, in line with delegation thresholds. Invest NI also told us that, apart from this project, the move away from leasing agreements means that, since the early 1990's, there has been no potential for IDB or Invest NI, to miss a break clause in a lease (**see paragraph 7**). However, there is an ongoing need for Invest NI to ensure that its systems highlight effectively other important time-based deadlines, such as rent reviews.

52. We consider that a particularly important lesson from this report is the need for the wider public sector to have systems in place which ensure that all time-bound decisions, which have important financial or commercial implications, are acted on in a timely basis.

Synergy e-Business Incubator (SeBI)



This report has been prepared under Article 8 of the Audit (Northern Ireland) Order 1987 for presentation to the Northern Ireland Assembly in accordance with Article 11 of that Order.

K J Donnelly
Comptroller and Auditor General

Northern Ireland Audit Office
24 March 2010

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Abbreviations

BT	British Telecom
DETI	Department of Enterprise, Trade and Investment
EUSSPPR	EU Special Support Programme for Peace and Reconciliation in Northern Ireland
IDB	Industrial Development Board
IFI	International Fund for Ireland
IRTU	Industrial Research and Technology Unit
LEDU	Local Enterprise Development Unit
NIAO	Northern Ireland Audit Office
NITAP	Northern Ireland Technology Assessment Programme
PAC	Committee of Public Accounts
SCL	Synergy Centres Ltd
SeBI	Synergy e-Business Incubator
SEV	Springvale Educational Village
UU	University of Ulster

Introduction

1. Synergy Centres Limited (SCL), a company limited by guarantee, was established jointly by International Computers (Ireland) Limited (latterly Fujitsu Services Ltd) and the University of Ulster (UU) in 1997. Until 2000, SCL consisted of two divisions – Synergy Learning (an e-learning development activity which provided cyberskills training for unemployed 18 to 25 year olds in North and West Belfast), and Osarius (a digital media business).
 2. In 2000, a third division of the company was formed, known as Synergy e-Business Incubator (SeBI). SeBI's business objective was to create a world-class software technology incubation unit which would encourage and develop entrepreneurship, and ultimately lead to the creation of 'information age' businesses. The unit was primarily aimed at fostering university 'spin-out' companies, and individuals with potentially viable information business proposals.
 3. The SeBI concept envisaged substantial benefits for the development of e-business in Northern Ireland, particularly for West Belfast, where the incubator was to be located. For example, it would have the capacity to house up to 20 start up businesses, and targets established for the scheme for the period June 2000 to June 2003 envisaged 108 jobs being created. In addition, it was anticipated that 13 companies would either leave, or be preparing to leave, the incubator and commence business operations independently.
 4. SeBI attracted government grant aid of £1.225 million over a 3-year period between 2000 and 2003, from the following sources:
 - the Department of Enterprise, Trade and Investment (DETI), under the EU Special Support Programme for Peace and Reconciliation in Northern Ireland (EUSPPR) (£975,000); and
 - the Industrial Research and Technology Unit (IRTU – later to merge into the new Invest NI in April 2002) (£250,000).
- In addition, the Local Enterprise Development Unit (LEDU - which also became part of Invest NI) subsequently provided support of £194,000 grant-aid to assist some of the SeBI incubatee companies with start up

Figure 1: Profile of expenditure by SeBI

Expenditure category	% of expenditure incurred
Staff costs (including consultancy, recruitment, secondments and travel costs)	50
Capital (refurbishment and fittings, equipment)	30
Overheads and running costs	17

Source : NIAO

costs, and the International Fund for Ireland (IFI) committed £150,000 to the project.

5. As **Figure 1** shows, SeBI subsequently utilised the grant-aid provided predominantly on staff and capital expenditure.
6. In May 2003, following on from its initial experiences with SeBI, SCL established the Northern Ireland Technology Assessment Programme (NITAP), primarily to assist entrepreneurs at the pre-incubation stage to take the first steps to develop technology based ideas into realistic business concepts. Between 2003 and 2006, NITAP received £212,000 funding from Invest NI under the LEAPFROG¹ initiative (**see Appendix 1**). The operations of SCL in the wider sense were also funded significantly by government. Between 1998 and 2006, the company received £2.6 million in revenue grants (46 per cent of its total income during this period).
7. When government funding for SeBI ceased in 2003, it was apparent that the project had fallen short on key targets and objectives, with underperformance in respect of the number of incubation units occupied, jobs created, and the number of companies exiting the site to trade independently. In addition, the cost per job created (£25,181) was considerably higher than initially envisaged (£12,250), and SeBI had not achieved a key objective of being financially self-sustaining. NITAP also underachieved against its targets, and by its closure in March 2006, only four companies had made it through to the final stage of the programme (the target was eight), with very few, if any, new jobs created.
8. The period in which SeBI and NITAP operated saw a global downturn in the technology sector which was exacerbated by the events of 11 September 2001. SeBI was also located in three different sites during its existence which, in our view, hampered the project's prospects of success. SCL began to experience financial difficulties from 2001 onwards, with declining turnover and a heavy reliance on government revenue grants. In 2002, mainly as the result of a group wide reorganisation, Fujitsu withdrew from SCL and UU became the sole owner. However, continuing deterioration in SCL's financial performance ultimately led to the company ceasing trading in December 2006. Although SCL had continued to operate the SeBI incubator, only five incubatees remained on the site at this stage. Of these, one relocated to the UU's Jordanstown incubator, two transferred to the Northern Ireland Science Park in Belfast's Titanic Quarter, and two left and were reported to be experiencing trading difficulties. SCL was wound up in February 2008, with a closing deficit of £1.01 million. The UU is liable for the majority of this deficit.

Scope of NIAO review

9. Due to the quantum of funding involved, this examination focused primarily on SeBI. However, a summary of our findings related to NITAP is contained at **Appendix 1**. In respect of SeBI, this report outlines:
 - the strategic context to the project (**paragraphs 10 to 13**);
 - performance against milestones and targets established for the project, and

¹ The LEAPFROG government initiative aims to promote 'a highly attractive and supportive knowledge based economy in Northern Ireland'.

the extent to which it achieved value for money (**paragraphs 14 to 23**); and

- appraisal and monitoring of the project (IRTU / Invest NI monitored both SeBI and NITAP on behalf of the funding bodies) (**paragraphs 24 to 48**).

In undertaking this review, we took account of the Committee of Public Accounts (PAC) report of May 1998, which focused on IRTU's administration of financial assistance schemes to local industry for research and development schemes². The Committee's report contained a range of conclusions and recommendations spanning the areas of project appraisal, monitoring and post project evaluation.

The strategic context to SeBI

10. The concept of an e-business incubator was initially embraced by SCL in January 1999, and informal discussions were held with IRTU and IFI during the summer and autumn of that year. Although SCL received positive indications of potential project funding, IRTU expressed some concerns regarding the forecast that the project would be self-financing by the fourth year of its operations. Nonetheless, it commissioned consultants in September 1999 to appraise SCL's business proposal. SCL also subsequently engaged consultants to advise on the incubator's implementation.
11. Both consultants' reports, completed in December 1999 and June 2000 respectively, highlighted a number of uncertainties and potential threats to the project's success:

IRTU review (December 1999)

- the objective of financial self-sustainability could not be determined with any certainty at this stage, and would be dependent on the level of commercial success achieved by incubating companies;
- SCL had not taken any decision on the project's proposed location, and this affected a number of key planning assumptions;
- further credibility would be added to the project if additional non-government up front funding was obtained; and
- availability of sufficient supply of incubatees was uncertain, when historically the IT market in Northern Ireland had been relatively small.

SCL review (June 2000)

- a lack of incubatee companies of sufficient quality;
- services supplied by SeBI to assist incubatees in developing their business concepts may not be of sufficient quality;
- conditions placed on incubatees to take part in the scheme may be too low to attract good business ideas; and
- a risk that incubatee companies would not perform well enough on a commercial basis to enable SeBI to realise equity in them (this was a condition of entry to the incubator).

² Committee of Public Accounts: Thirty-Eighth Report; Northern Ireland: The Industrial Research and Technology Unit – HC 429 – 19 May 1998.

12. Although the IRTU review had flagged up important concerns which later impacted on the project's success (**see paragraph 28 and Figure 5**), its overall view was that the project was valid in principle. Consequently, following further discussions with SCL, IRTU recommended financial assistance of £1.225 million for the project in December 1999 - £975,000 of which related to the DETI European Special Support Programme for Peace and Reconciliation funding.
13. As **paragraph 11** indicated, the consultants engaged by SCL had also identified potential threats to the project's success. However, on the whole, they also considered that the SeBI concept was well founded. Their forecasts for project outcomes were considerably more positive than the IRTU review. For example, the consultants stated that *"A conservative reckoning of this initiative is that it should be commercially viable in 4 to 5 years, thereafter in cash surplus on an annual basis.....In employment terms the project will initiate at least 60 sustainable businesses.....and create 2,308 new jobs in the new economy with a further 1,158 positions indirectly supported by those new businesses"*. The targets set out in the letters of offer issued by DETI and IRTU were lower than the outcomes predicted in this report, and did not reflect the degree of optimism expressed by SCL's consultants. Consequently, DETI stated that the consultant's report had not



been relevant to the decision making process for this project.

Performance against milestones and targets:

SeBI attracted public sector funding, but failed to deliver the anticipated benefits

14. Having received an offer of grant from DETI, SeBI commenced operations in June 2000. By the time IRTU made its grant offer in October 2000, total planned funding for the project amounted to almost £2.04 million. Some £1.225 million (60 per cent) of this was to be provided through public sector funding (see Figure 2). The International Fund for Ireland (IFI) also made a commitment of £150,000 to the project.
15. In making their grant offers, both DETI and IRTU attached specific milestones relating to the level of performance against which the incubator success would be measured (see Figure 3). However, these were not linked to payment of grant, but were

instead indicators against which project outcomes would be monitored. This is mainly because the nature of this project did not facilitate linking ongoing payment of grant to achievement of the milestones, as these related to anticipated outcomes at the end of the respective grant periods. Furthermore, projects such as this, whilst important from an economic development perspective, are high risk ventures, aimed at promoting innovative business proposals, and applying clawback of grant for non-attainment of milestones would be largely self defeating, and potentially discourage the promotion of such ventures.

16. However, such an approach ultimately results in a significant proportion of the risks associated with these types of projects passing to the public sector. It is therefore essential that these are subject to the highest standard of project management and monitoring, by both project sponsors and funders, to counter potential risks and under-performance. However, as this report later highlights (paragraphs 24 to 48), there were a number of shortcomings in this regard.

Figure 2 : Planned funding for SeBI project at October 2000

Funding source	£ million	% total funding
DETI (EUSSPPR)	0.975	48
IRTU	0.250	12
Total public sector funding	1.225	60
SCL ³	0.417	21
IFI	0.150	7
Incubator earned income	0.247	12
Total project funding	2.039	100

Source: NIAO

3 Included in the funding committed by SCL, UU provided 'in kind' contributions to the project, including staff time.

17. IRTU reiterated the status of the milestones to SCL in a letter in July 2001, stating that *"attainment of these targets is not a condition of the letter of offer. They are merely targets against which SeBI's performance is continually monitored by IRTU"*. Whilst this was a statement of fact, we consider that it may also have conveyed an impression to SCL that achievement of the milestones for SeBI was not a priority for achieving maximum success for the project.
18. With IRTU / Invest NI funding of SeBI having ceased in June 2003, the terms of grant-aid required SCL to submit a 'closing report' for the project, within six months of last funding. The report, received by Invest NI in April 2004, outlined performance against the milestones attached to IRTU's grant offer. As **Figure 4** shows, SCL reported underperformance against all the targets.

Figure 3 : Summary of milestones attached to DETI and IRTU / Invest NI funding for SeBI project

Milestones attached to DETI grant offer (May 2000) (period of grant June 2000 to September 2001)⁴

Establish the incubator by June 2000

By the end of September 2001:

- achieve 15 incubator units
- create 9 jobs within the incubator and 75 jobs within incubator companies (i.e. a total of 84 jobs)
- 8 companies preparing to leave the incubator

Milestones attached to IRTU grant offer (October 2000) (period of grant October 2000 to June 2003)⁵

By June 2003:

- 20 incubator units to be occupied
- create 10 jobs within the incubator and 100 jobs within incubator companies (i.e. a total of 110 jobs)
- 13 companies to have exited, or preparing to exit
- SeBI to achieve financial self-sustainability

Source: NIAO

Figure 4 : Performance for SeBI project as reported by SCL closing report

Milestone / target	Target established by IRTU	Performance reported by SCL at June 2003
Units occupied	20	15
Jobs created within SeBI	8 ⁶	2
Jobs created within incubator companies	100	53
Companies exited or preparing to exit incubator	13	9

Source: NIAO

⁴ The period of DETI grant funding was subsequently extended to November 2001, to facilitate the submission of grant claims

⁵ The period of IRTU grant funding, and for achievement of the milestones, was extended from December 2002 to June 2003

⁶ This refers to 8 direct jobs which were to be created within SeBI – the IRTU grant offer (see **Figure 3**) established a milestone for a total of 10 jobs (8 direct plus 2 indirect).

19. Following receipt of SCL's report, and in line with good practice, Invest NI commissioned consultants to undertake a post project review of SeBI. However, the consultants were unable to verify the performance outputs for the project which had been claimed by SCL, due to a lack of reliable management information. One example of the problems experienced was that whilst SCL claimed that 20 incubatee companies had been located within SeBI by this stage, addresses for only eight could be located, despite extensive searches and enquiries. We encountered similar difficulties, and were unable to source data which provided any assurance that SCL had accurately reported project performance. For example, of the 53 incubatee jobs claimed (**see Figure 4**), 18 related to Synergy Learning. We consider that this is inappropriate, given that this division of SCL already existed prior to the establishment of SeBI.
20. On the basis of the limited information available, we attempted to construct performance data for SeBI from 2000 to 2003. We concluded that:
 - 14 incubatee companies may have been housed during the project's lifetime (Targets: DETI -1.5 IRTU / Invest NI -20);
 - there was little evidence to substantiate the existence of 7 virtual⁷ incubatee companies claimed to have been serviced by SeBI;
 - 12 companies may have exited the incubator by June 2003 (Targets: DETI – 8 IRTU / Invest NI - 13);
 - employment within SeBI peaked at 7, but declined to 2 by June 2003 (Targets: DETI – 9 IRTU / Invest NI – 10);
 - employment in incubator companies appeared to total 39, with a further possible 8 jobs in virtual incubatees (Targets: DETI – 75 IRTU / Invest NI – 100); and
 - of 21 companies which SeBI may have housed or serviced, 7 appeared to have been trading in 2007 (but their trading performance could not be demonstrated), 6 were either dormant, or wound up, and no information was available on the remaining 8.
21. A further milestone linked to IRTU / Invest NI grant-aid required SeBI to be financially self-sustaining by June 2003. This was largely dependent on incubatees, prior to progressing to the final stage of business development, entering into an agreement with SCL to take an equity share of between 5 and 15 per cent, in their company (**see paragraph 10**). Although Invest NI was unable to tell us the degree to which SCL secured equity holdings, we consider that this is unsurprising, given that we saw no evidence that it carried out any ongoing monitoring on the progress being made by SeBI to achieve this key operational objective.
22. Available records suggest that SCL acquired an interest in eight companies, but ultimately only realised equity in two. Furthermore, total equity realised (just under £60,000), was substantially lower than envisaged. Of the remaining six companies, one

⁷ Companies which SeBI claimed to have provided advice and support to, but which were not physically located within the incubator.

never traded, and SCL relinquished its holdings in the other five, with evidence suggesting that, in three cases, this was due to disputes over the quality and value of SeBI support services. In 2002, following Fujitsu's departure (**see paragraph 7**), SCL amended the terms of leases for future SeBI incubatees to a standard rental charge, with no equity interest. Although this represented a fundamental change to the arrangements for the financing of SeBI, we found no evidence that Invest NI was aware of it, or had been consulted on the matter. Against this background, it was almost inevitable that SeBI never subsequently achieved financial self-sustainability.

NIAO conclusion

23. Final government grant-aid payable to the SeBI project amounted to £1.18 million, with additional IFI funding of £0.15 million. We recognise that this is relatively small in terms of the overall industrial development and technical research budget. We also acknowledge that investments in creative projects of this nature invariably require funding bodies to bear a considerable element of risk, which can potentially yield significant benefits in terms of local businesses' development and job creation. Nonetheless, it is



apparent that the SeBI project fell short of delivering the anticipated benefits:

- the level of interest in terms of business start ups was lower than forecast;
- the number of jobs created within both SeBI (2), and the incubator (39) fell substantially below project targets and milestones;
- the evidence available suggests that the number of long term jobs created was very small; and
- the project never achieved a key objective of being financially self-sustaining.

Overall, given the level of under-performance, we consider that the value for money achieved from this project was very poor, and it is necessary to ask what lessons can be learnt from this.

Project appraisal and monitoring:

There were shortcomings in the appraisal and monitoring of SeBI

24. This section of the report examines how well the SeBI project was appraised and monitored, and the extent to which problems in these areas may have contributed to the project's disappointing outcomes.

A poor audit trail hindered our examination

25. Following PAC's 1998 report (**see paragraph 9**), IRTU assured the Committee that it had developed systematic procedures for monitoring projects against specified targets, milestones and commercial outcomes, and that a computerised project management system ensured these requirements were fully and consistently applied. However, our examination of SeBI was hampered by both Invest NI and DETI's inability to produce documentation on their response to the PAC report, and the subsequent sequence of events surrounding the claimed introduction of revised project management and evaluation arrangements. A general theme of our examination was that key documents could only be traced after extensive searches. Furthermore, although a computerised management system was introduced in 1996 covering over 80 per cent of IRTU project expenditure, this did not include the Foresight programme, which was the funding stream for SeBI.

26. We recognise that this review covered a period which saw major reorganisation of the industrial development and technology research bodies, with LEDU, IRTU and IDB amalgamating to form Invest NI in April 2002. However, the absence of a reliable audit trail or a single source of key documents relating to SeBI, particularly within IRTU (which had overall responsibility for monitoring the project - **see paragraph 9**) is of concern. Moreover, whilst appropriate follow-up action may have been taken on the 1998 PAC report, the absence of reliable evidence causes concern that

important undertakings to the Committee were not actioned.

27. It is a basic requirement of sound public administration that a proper audit trail, which shows the development and history of supported projects, with a log and full copies of important documents, should be maintained by funding and monitoring bodies. Furthermore, improvements to procedures introduced in response to PAC reports should be clearly documented.

Key concerns highlighted by the initial appraisal of SeBI were not followed up

28. Whilst the SeBI concept was endorsed as valid by both sets of consultants who appraised the project (**see paragraph 13**), the initial review commissioned by IRTU flagged up a number of important and relevant observations, which subsequently impacted on the project's success (**see Figure 5**):

29. Despite the significance and timeliness of the issues raised, we found no evidence that these were given any further meaningful consideration within the subsequent appraisal or casework submission process. In dealing with projects such as SeBI, which carry a considerable element of risk, it is particularly important that recognised procedures which have been established to assist successful project selection are fully observed. In our view, more detailed consideration of the factors highlighted by the consultants during the appraisal process may have enabled the significance of project risks to have been better quantified, and taken into account when deciding whether to fund the project.

30. It should be basic good practice that key issues and threats to projects which are raised by the appraisal and monitoring process should be subject to thorough and transparent consideration, and brought to the attention of relevant Casework Committees⁸ as part of the funding approval process.

Figure 5 : Summary of issues identified by consultants during appraisal of SeBI and subsequent project outcomes

Consultants' appraisal observations	SeBI project outcome
Financial self-sustainability could not be determined and relied on the commercial success of incubating companies	Project never achieved financial self-sustainability
Further credibility would be gained if additional non-government funding were obtained	Further non-government funding was not secured (grant-aid accounted for almost 80 per cent of project spend)
Difficult to demonstrate sufficient supply of enabling companies, when the IT market in Northern Ireland had historically been small	Occupancy of the incubator lower than forecast and evidence indicates that very few quality, sustainable businesses or jobs were created

Source: NIAO

8 Casework Committees are responsible for arriving at an informed decision on whether funding should be committed to proposed projects. To inform their decision, Casework Committees are provided with a submission which details the amount and form of assistance proposed, and the factors which are likely to impact on the project's success.

Funding was not subject to approval by the IRTU Casework Committee

31. In commenting on the appraisal process in its 1998 report, PAC noted the importance of funding applications being subject to consideration and approval by the Casework Committee. PAC stated that *“scrutiny by the Casework Committee is an important control and not one that we see as unnecessarily bureaucratic”*. However, whilst there appeared to have been approval by a senior official within DETI for the EUSSPPR funding, and within IRTU for the funding under the Foresight programme, we saw no evidence of any IRTU Casework Committee process to consider or approve the IRTU grant offer.

32. It is imperative that funding applications for public monies should be subject to a robust project appraisal process and applications involving significant amounts of public money should be considered by a Casework Committee before making a decision to fund. In the case of SeBI, we consider it self-evident that the total funding committed to the project warranted Casework Committee consideration.

SeBI was not reappraised following key events, and there were shortcomings in project monitoring

33. Having assumed responsibility for monitoring SeBI's operational performance (see paragraph 9), IRTU appointed a Client Executive for this purpose in May 2000. A series of key events subsequently arose, which ultimately impacted on SCL's commercial viability:

- the company's trading performance began to deteriorate from late 2001 onwards;
- in April 2002, Fujitsu reached an agreement with UU to divest its interest in the company, which thereafter operated under sole UU ownership; and
- in November 2002, UU abandoned its involvement in the Springvale Educational Village (SEV), the incubation units' proposed permanent home. Location was a recurring issue which impacted on its potential success throughout, as SeBI was based in three different sites between 2000 and 2003.

Although these outcomes had obvious potential implications for SCL's financial performance and viability, and for SeBI's operations, we found no evidence that Invest NI acted to re-appraise the viability of the project, and the merits of continuing to fund it, following any of these events.

34. We consider that there should be no hesitation in undertaking project reviews or re-appraisals, should monitoring indicate potential threats to companies, or supported projects, not foreseen in the initial appraisal.

35. The failure to re-appraise SeBI may have been attributable to shortfalls in SCL's performance reporting for the project, and to inadequate project monitoring by IRTU / Invest NI. These meant that IRTU / Invest NI were often unsighted on important issues affecting the operations of the incubator, or SCL in the wider sense. For example, whilst SCL was required to submit regular progress

reports for SeBI, and its own annual reports and accounts, key information was often not provided, or superficial in nature. In respect of SeBI:

- monthly reports submitted to IRTU / Invest NI often lacked detail, and did not include SCL Board minutes, as had been agreed. Furthermore, information on SeBI spend against forecast was not provided; and
- four-monthly reports for DETI / IRTU were produced irregularly, and did not contain all information required to properly manage the project. In addition, statistical information was often inconsistent with earlier data provided by SCL.

36. Perhaps most crucially, we saw no evidence that SCL submitted its annual reports and audited accounts as required, or that IRTU / Invest NI carried out any financial analysis of the company, as part of ongoing monitoring. In our view, such analysis was an essential component of monitoring SeBI, given the nature of its relationship with SCL. Failure to undertake this monitoring meant that the funding bodies did not have an understanding of SCL's underlying financial problems, or the obvious implications of these for SeBI. Consequently, the relevant bodies were not alerted to the need for possible early intervention or re-appraisal of project funding.

37. Promoters of projects must be made fully aware of their responsibilities by project sponsors for maintaining full management and financial information on projects for

scrutiny by funding bodies, and of the potential penalties of not doing so.

Post project reporting was delayed and lacked detail

38. Terms of grant required SCL to produce a 'closing report' for SeBI (**see paragraph 18**), no later than six months after project funding had ended. However, although an initial draft was submitted within this timescale, Invest NI's Client Executive (responsible for overseeing the project at that time) referred this back to SCL, due to significant issues with the quality and completeness of the document. Consequently, the final version was substantially delayed, being received by Invest NI in April 2004 (10 months after project funding ended). This report, which remained substantially unchanged from the initial draft, concluded that SeBI:

- represented a positive move to position Northern Ireland as a centre of significance in the global market for the development and application of e-business technologies;
- had enhanced support services available to start up technology businesses in the region; and
- had suffered due to the global economic downturn in the sector, which had reduced start up confidence, and impacted directly on SeBI client numbers.

39. Whilst this reflected a mainly positive outcome, it could not have been regarded as a wholly objective review of SeBI, given that it was produced by the project sponsor.

Furthermore, we consider that the report was not detailed enough to permit a meaningful assessment of project performance.

Particular weaknesses included a lack of information on incubator entry / exit dates, the current status and location of companies, numbers of staff employed and details of SeBI equity holdings in incubatee companies, despite Invest NI having raised many of these concerns with SCL following a review of an earlier draft of the document. In our view, the absence of such information, which ultimately hindered proper evaluation of the project, was unsurprising, given the shortfalls within SCL's ongoing progress reports (**see paragraph 35**). In line with its policy, Invest NI commissioned an independent post project review of SeBI.

40. As **paragraph 19** noted, the consultants commissioned by Invest NI to undertake this evaluation also encountered significant difficulties in identifying reliable management information for SeBI (only 8 of 20 incubatees claimed by SCL could be located). Consequently, their report was not received until March 2005 (21 months after project completion). The consultants' main conclusions were that:

- the project concept was reasonable and appropriate in early 2000, but progress had been hindered by the collapse of the ICT boom, and Fujitsu's withdrawal;
- SeBI had performed badly in value for money terms;
- there had been no apparent monitoring by IRTU / Invest NI of SCL's business performance, as promoter of SeBI, and

there were concerns over SCL's ongoing financial sustainability; and

- the small number of incubatees who could be contacted considered that the quality and volume of service provided by SeBI was poor.

Having assessed both post project reports, Invest NI's final assessment was that some changes could have been made to the project in a more timely fashion, but that the majority of challenges lay outside the control of both itself and SCL.

NIAO conclusion

41. Whilst we do not underestimate the external factors which impacted on SeBI, we consider that there was clear scope for the appraisal and monitoring process to have been much better managed. In particular:

- project risks could have been assessed more robustly during appraisal, particularly as Invest NI consultants had highlighted at an early stage some relevant threats which subsequently impacted negatively on the project's success;
- there should have been consideration of all relevant facts by the Casework Committee(s) in approving funding for the project; and
- ongoing performance monitoring should have been more robust. In particular: little action was taken to challenge

inadequate management information submitted by SCL; there was no apparent monitoring of SCL's financial performance; and the project was not re-appraised in the face of several key events in SCL which had obvious potential to impact on SeBI.

Again, it is important to reiterate that potentially high risk projects should be subject to appraisal and monitoring procedures, which are in line with best practice, if they are to have the optimum chance of success.

42. In this case, project monitoring by IRTU / Invest NI should have ensured the receipt of timely and comprehensive information, both financial and non-financial. This should have included copies of SCL Board minutes, together with all reports on SCL and SeBI provided to the SCL Board.

43. We also consider that there were shortfalls within the post project evaluation process, mainly associated with the poor standard of management information for SeBI:
- this was protracted for a relatively small project, taking 27 months in total to complete - clearly at variance with PAC's 1998 recommendation that evaluations be completed promptly, and lessons incorporated into procedures at the earliest opportunity; and
 - the post project evaluation process, aside from the consultant's review commissioned by Invest NI, was superficial, and failed to address, or report on, key issues.

44. Promoters of projects should not be permitted to evade their responsibilities for submitting comprehensive and accurate closing reports in a timely manner. In this instance, the failure to do this ultimately delayed the completion of the overall post project review process, meaning that examples of good and poor practice could not be disseminated in a timely manner. Furthermore, in projects such as SeBI, which involve significant amounts of expenditure, the final stage within the post project evaluation process should involve an independent assessment, and the key findings of this should be accepted by the funding body as being the most objective evaluation of project outcomes (**see paragraph 40**).

Despite poor project performance, there was little scope for applying clawback of funding in projects such as SeBI

45. Overall, the SeBI project fell short of expectations, and ultimately achieved very little. However, we acknowledge that the project operated during a difficult period in which there was a global downturn in the technology sector (**see paragraph 8**), which impacted on its potential to succeed. Despite the poor performance of SeBI, Invest NI is not in a position to initiate clawback of any project funding because, as **paragraph 15** indicated, achievement of the targets and milestones was not a condition of grant. DETI told us that for projects of this type, withholding or clawing back grant should be linked to the promoters' diligent implementation of the project, rather than achievement of milestones or targets.

46. Given this, we asked DETI whether it had considered withholding or applying clawback of grant on the grounds of poor project implementation. DETI said that Invest NI believed that the promoter was making reasonable efforts to deliver required outcomes. It said that none of the issues identified during the monitoring of project implementation suggested that there was a lack of diligence on the part of the promoter and at no time was a default event deemed to have occurred, and grant was not, therefore, withheld. DETI said that in view of the external events that occurred during the lifetime of the project, for example the global downturn in the technology sector and the events of 11 September 2001, it would have been extremely difficult to argue persuasively that the promoter was not exercising diligence in implementing the project.

- delayed and superficial post project reporting; and
- poor quality services being supplied to incubatee companies.

48. When there are no provisions to clawback grant for the failure to meet project targets, risks rest with the public sector, and it is important that project management and monitoring is of the highest standard, to help counter under-performance. In such instances, letters of offer should include provisions to withhold or clawback grant in the event that the promoter is deemed to be in breach of any of its obligations, including poor project management and monitoring. Furthermore, project funders should enforce these clauses when necessary and appropriate.

NIAO Conclusion

47. However, it is our view that the shortcomings highlighted in this report indicate that SeBI was not always implemented in a diligent manner, and that there are clear lessons for future application. Evidence of specific weaknesses with the promoter's implementation of the project included:

- management information submitted irregularly and of a poor quality;
- the requirement for incubatee companies to share equity being amended to less favourable terms, without any approval by project funders;

Appendix 1: NIAO examination of the Northern Ireland Technology Assessment Programme (NITAP) – key findings (Paragraph 6)

The strategic context

NITAP grew largely out of SCL's initial experience with SeBI, and its primary aim was to provide greater focus on assessing and developing potentially innovative ICT knowledge based ideas and concepts at the pre-incubation stage. LEAPFROG (see Footnote 1) funding of £373,500 was approved by Invest NI for NITAP in March 2003, on the understanding that SCL and British Telecom (BT) funded the balance of £197,000.

NITAP under-performed against key targets

Whilst an initial economic appraisal envisaged NITAP delivering 10-25 new businesses, and 60-80 new jobs, this was revised to 100-120 jobs, and 30 new business start ups. However, formal targets agreed between SCL and Invest NI were based around uptake of the different stages of the programme (see Figure 6), and post project review findings for NITAP in May 2006, analysed performance on this basis, with no reference to

jobs created. As Figure 6 shows, NITAP under-performed against all but one of these indicators, and only four companies made it through to the programme's final stage.

Of 12 NITAP participants interviewed by NIAO, three confirmed their involvement had resulted in the establishment of a new, or expansion of an already existing business, but none indicated any new employment created, suggesting that the project generated very few, if any, new jobs. **Clearly, NITAP's performance on all fronts did not live up to expectations.**

There were recurring issues similar to SeBI with regards to project appraisal and monitoring

- *NITAP was not re-appraised following key events*

A considerable period (15 months) elapsed between commencement of the NITAP appraisal process, and approval of funding by the Casework

Figure 6: Performance of the NITAP Project

Programme target	Performance	Under-performance (%)
Conduct 150 critical factor analyses	87 conducted	42
Undertake 60 technical / software / process or market appraisals	38 undertaken	37
Develop a training programme	Training programme licensed	n/a
Deliver 60 training modules	34 delivered	43
Provide tailored marketing supports for 8 businesses (final stage of the programme)	4 provided	50
Develop an ideas / knowledge management system	Ideas management system partially completed	n/a

Source: NIAO

Committee, during which key events relevant to the project occurred:

- Fujitsu withdrew from SCL in April 2002 (**see paragraph 8**);
- SCL's trading performance deteriorated in the face of global downturn in the ICT sector (**see paragraph 33**); and
- the SeBI project experienced considerable under-performance (**see paragraphs 14 to 22**).

Despite the passage of time, and the interim events, Invest NI did not arrange for SCL to provide an updated business proposal for NITAP. Furthermore, the financial information relating to SCL which was made available to the Casework Committee in March 2003 consisted of only 2000-01 draft accounts, meaning that the Committee was unaware of SCL's subsequent deteriorating financial performance.

In our view:

- **NITAP should have been re-appraised following the key events which impacted on its potential success; and**
- **information presented to the Casework Committee did not facilitate it in reaching a fully informed decision, with regard to all prevailing factors at the time, on the merits of funding the project.**

– *Operational monitoring was inadequate*

As **paragraph 35** indicated, IRTU / Invest NI carried out little or no monitoring of SCL's financial performance. Such monitoring was essential, particularly as SCL's deteriorating

trading performance (from late 2001 onwards) coincided with the development and appraisal of NITAP. In our view, more robust monitoring of SCL's performance may have enabled the relevant funding bodies to have reached a more informed judgement on the merits of funding the project. Operational monitoring of NITAP was inadequate in a number of other respects. For example, we saw no evidence that any quarterly progress reports were submitted, as required by the terms of grant.

– *There has been no clawback of funding despite poor project performance and SCL ceasing trading*

Despite the project's poor performance, and SCL ceasing trading in December 2006, Invest NI did not take any steps to initiate clawback of grant-aid. Furthermore, in December 2006, when Invest NI was clearly aware of the shortfalls in the project's performance, it issued a final revised grant offer for NITAP, which contained amended (reduced) milestones and targets in proportion to the reduction in grant paid for the project (£211,700 was claimed against the £373,500 approved). In our view, this indicates that Invest NI accepted the underperformance, and consciously decided not to pursue clawback. However, any prospect for clawback may have been remote, as we found no evidence that Invest NI had ensured that a cross-guarantee had been put in place by UU.

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