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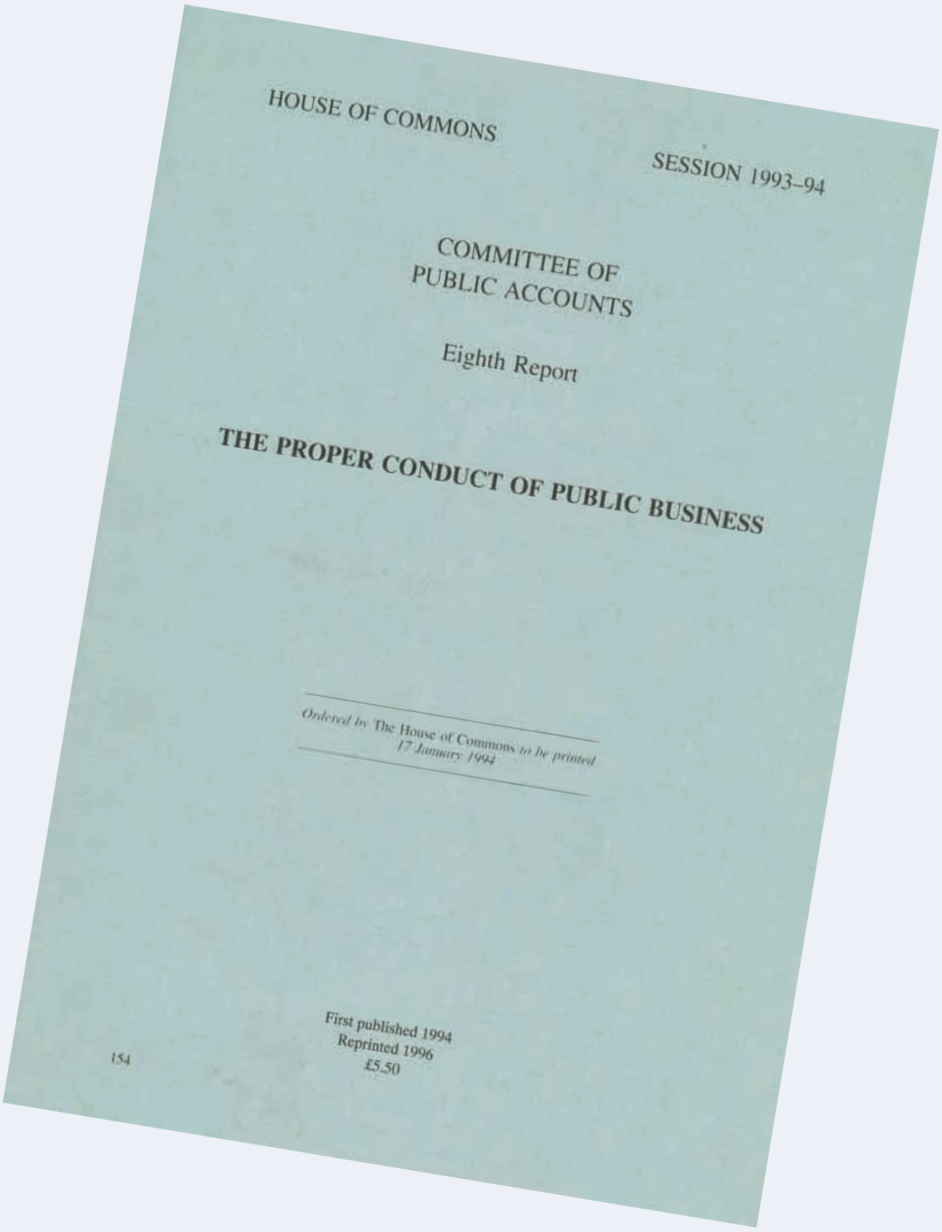
Governance Issues in the Department of Enterprise, Trade and Investment's Former Local Enterprise Development Unit

In Relation to the Establishment and Oversight of the Emerging Business Trust Loan and Venture Funds

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HC 817, Session 2005-06, 9 February 2006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J M Dowdall CB
Comptroller and Auditor General

Northern Ireland Audit Office
7 February 2006

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Introduction

1. The former Local Enterprise Development Unit (LEDU)[1] was a non-departmental public body (NDPB) with responsibility for supporting small scale local economic development, sponsored by the former Department of Economic Development which became from December 1999, the Department of Enterprise, Trade and Investment (the Department). LEDU ceased to exist in April 2002, when its functions and staff became part of a new, single development agency, Invest Northern Ireland.

2. This Report examines major weaknesses in the part played by the former LEDU in the establishment and oversight of the Emerging Business Trust (EBT), which had its origin in a £1 million Pilot Loan Fund established and operated by the International Fund for Ireland[2] (the International Fund) in March 1994. This Loan Fund replicated an earlier International Fund initiative to establish a loan fund in the Cavan County Enterprise Board. In 1996 the International Fund invited a number of organisations to submit tenders to take forward the further development of the Loan Fund.

3. This led, in September 1996, to the creation of the EBT with funds of £3 million provided by the International Fund and £0.75 million provided by the former LEDU. The purpose of the Fund was to provide access to finance for new business starts in disadvantaged areas and for individuals whose circumstances made access to finance difficult. EBT was structured as a company limited by guarantee with a Board of ten members selected after a consultation process involving the International Fund, a firm of chartered accountants known as MTF, and the former LEDU.

4. In 2000, EBT also established a Venture Fund to assist in financing emerging businesses in disadvantaged areas of Northern Ireland. The Venture Fund was provided with funding of £0.4 million by the International Fund and £0.2 million by the former LEDU. EBT voluntarily ceased to carry on business in April 2005 and a Liquidator was appointed by the creditors to wind up the affairs of both the Loan and Venture Funds.

5. It is important to note that EBT, while having the form of a company, has been almost entirely funded by public money – either from the taxpayer (through the former LEDU) or overseas governments (through the International Fund). The Department of Finance and Personnel (DFP) told us that the Board of the International Fund would expect those departments with whom it operates in partnership, to exercise appropriate oversight of the activities of the organisations it supports.

6. Although the sums involved are not very large, the distribution of public funds through Loan and Venture Capital mechanisms of this type is potentially sensitive as the decisions to support particular enterprises will inevitably be selective and will often be high risk. There are well established procedures to safeguard the application of selective financial assistance, and the Committee of Public Accounts (PAC) has made it very clear in its consideration of previous casework that it expects these safeguards to be carefully applied.

7. EBT can be described as a Third Party Organisation (TPO), not part of Government but involved in the delivery of public initiatives. When Invest Northern Ireland was established in 2002, it inherited the former LEDU's contracts with around 40 TPOs including EBT. Invest Northern Ireland's Corporate Finance Appraisal and Advisory Division has expertise in managing public sector involvement in venture capital activity. The Division undertook a review of the available files and immediately identified a range of concerns

1 The former LEDU was unusual amongst the larger non-departmental public bodies in Northern Ireland in that it was incorporated under the terms of the Companies (Northern Ireland) Order 1986 and its accounts were not, therefore, audited by the Comptroller and Auditor General (C&AG), although the C&AG did have inspection rights. The accounts of LEDU were audited by private sector auditors. The C&AG has been appointed the auditor of the successor body Invest Northern Ireland.

2 The International Fund for Ireland is an independent organisation established by the British and Irish governments in 1986. It is funded by overseas governments and its objectives are to promote economic and social advancement, and reconciliation between the communities in Ireland. The Fund gives priority to projects located in the most disadvantaged areas in Northern Ireland and the six border counties of the Republic of Ireland.

about the part played by the former LEDU in the establishment and oversight of the EBT Funds, including the perceptions of conflict of interest. Following consultation with the Department, a Steering Group was established to investigate the issues raised, and PriceWaterhouseCoopers was retained by solicitors on behalf of Invest Northern Ireland to investigate the establishment and operation of EBT.

8. This Report has drawn heavily on the Invest Northern Ireland investigation (the investigation) and has focussed on the following issues:

- conflict of interest and other issues in the establishment of the EBT Funds (see Part 1 of this Report);
- conflicting relationships and transactions between managers and companies assisted by the Funds (see Part 2 of this Report);
- performance of the Funds (see Part 3 of this Report); and
- adequacy of LEDU's monitoring regime (see Part 4 of this Report).

A chronology of the EBT Loan and Venture Funds is set out at Appendix 1.

Summary of the Investigation's Findings

9. Invest Northern Ireland and the Department are to be commended for promptly identifying the need to investigate this case and the thoroughness of their investigation, which revealed the most fundamental weaknesses in the former LEDU's decision-making and oversight of EBT.

10. The investigation identified a wide range of problems including:

- the former LEDU failed to ensure that the structures for the Funds were appropriate. This contributed to the formation of an organisation that stood to benefit an existing LEDU Board Member, Mrs Teresa Townsley. The combination of roles undertaken by Mrs Townsley in relation to EBT was inherently conflicting. She was LEDU's Deputy Chair, a member of both the Loan Fund and the Venture Fund Boards, and a partner in MTF Chartered Accountants (MTF) who were the lead managing agents of both Funds (paragraph 1.44). Management fees of over £1.4 million were paid to MTF between 1997 and 2005 (paragraph 3.23);
- in contravention of its own procedures, the former LEDU failed to undertake an independent appraisal of the business case to provide financial assistance to the Loan Fund. LEDU failed to ensure that its Letters of Offer covered such basic matters as obtaining proof that the conditions of funding were met (paragraph 1.47);
- the normal public sector rules on competitive tendering were not followed and the contract for management services was awarded on a three-year rolling basis to MTF. This, in particular, has left the former LEDU not well placed to defend itself against allegations of favouritism towards a firm jointly owned by a LEDU Board Member and her husband (paragraph 1.47);
- significant conflicts of interest existed in the relationship between MTF and a number of client companies of EBT. These should have been avoided. Where disclosures were made they were not well handled (paragraph 2.21);
- there was a high level of bad debt – in total, £1.1 million of loans made by the fund were written-off. This contributed to the investigation's view that there is an element of doubt as to whether loan management fees of £760,000 paid by EBT (out of total fees of £1.4 million) represents value for money (paragraphs 3.8 and 3.23); and
- there is insufficient evidence of vouching and proactive monitoring by LEDU (paragraph 4.2).

Mrs Townsley and other former directors were consulted on a draft of this Report. Mrs Townsley's comments on the draft are set out in her letter of 5 January 2006 (see Appendix 2). Where amendments to the Report were required as a result of our consideration of Mrs Townsley's and other former directors' comments, these have been made.

11. We asked Invest Northern Ireland whether, in view of the extent of the conflicts of interest in this case, the failure to deal with them and the unusually wide range of other control failures, it had considered whether there was collusion by former LEDU staff or other illegality. We also asked Invest Northern Ireland to provide details of any investigations still ongoing into any aspects of the issues or individuals referred to in this Report. Invest Northern Ireland told us that in commissioning the investigation, the possibility of collusion was considered and the investigation was alerted to this possibility. A thorough and rigorous investigation was conducted involving interviews with relevant staff members and all connected parties. The investigation found no evidence of collusion. Furthermore, the details of this case have been discussed with the Police Service of Northern Ireland which considered that there is no basis for further investigation into any criminal charges. The Department also told us, Invest Northern Ireland is investigating three other bodies, established between 1990 and 1998, where there are points in common with EBT and concerns about the proper use of public funds. The Northern Ireland Audit Office (NIAO) has been consulted by the Department on these investigations and will have full access to the results.

The Proper Conduct of Public Business

12. The Proper Conduct of Public Business[3] was a landmark Report published by PAC in 1994 – at about the time the Pilot Loan Fund was being established by the International Fund. PAC identified a number of serious failures in administrative and financial systems and controls within departments and other public bodies, which had led to money being wasted or otherwise improperly spent. Alongside these failings the Report set out a checklist of points which public bodies needed to keep in mind in order to guard against the risk of such lapses. In Northern Ireland the Report was issued to all Accounting Officers by DFP.[4] NIAO has noted that many of the problems in this case indicate a failure to apply important lessons identified by PAC and published in the Report. These include the following:

- payment of grants on the basis of insufficient evidence as to entitlement;
- failure by departments to establish effective monitoring of NDPBs which they fund and sponsor;
- generally accepted principles of full and open competition not always observed when contracting out the provision of goods and services; and
- failure to secure arm's length relationships with private sector consultants, leading to conflicts of interest in decisions to spend public money.

13. Any one of these failures would be disturbing but, when taken together, they suggest a corporate culture in the former LEDU which simply did not understand or recognise the importance of its own operating rules, nor the wide range of guidance available to public bodies from DFP and PAC.

14. The former LEDU was not a minor NDPB on the fringes of the public sector; it was an integral part of what the Department had termed as its "family" of sponsored bodies. It had an overall budget of around £36 million[5] and was responsible for major programmes including selective financial assistance to small businesses. LEDU Board Members were appointed by the Department. LEDU's Chief Executive sat on the Department's Board and a senior official from the Department was present at LEDU Board meetings. The poor standards of administration and control revealed by this investigation are surprising in

3 Committee of Public Accounts, Eighth Report of Session 1993-94 'The Proper Conduct of Public Business' (HC 154).

4 DAO (DFP) 1-94.

5 The former LEDU's Annual Report and Accounts for 2001-2002.

a body of this importance. In our view they fall far below the normal standards which operate elsewhere in the Northern Ireland Public Sector. This is supported by the fact that, almost as soon as the EBT case was handed over to the new Invest Northern Ireland, the deficiencies were recognised and a major enquiry begun with the assistance of forensic investigators.

15. This case comes in the context of a number of instances of weak corporate governance practice in the former LEDU. Concerns have been raised in a range of PAC and NIAO reports (see Appendix 3). The key areas of concern included:

- frauds in LEDU's Finance Department in the late 1990s; and
- qualification of Invest Northern Ireland's 2002-2003 and 2003-2004 financial statements because of serious deficiencies in the management and control of TPO contracts inherited from LEDU. In particular, there was a lack of financial control, and extravagance in relation to corporate hospitality and overseas visits in a TPO known as 'Into the West'.

NIAO and PAC have also raised issues relating to the handling of conflicts of interest in the Northern Ireland Tourist Board.

16. The former LEDU's handling of EBT provides a classic illustration that it is not sufficient to have controls, manuals and codes of conduct, all of which were in place in LEDU - they actually have to be applied. At almost every stage of this project, there was a breakdown of normal controls and procedures. There is a close parallel to this in the failures found in the 'Into the West' case. In NIAO's view, these two cases point to a profound failure of governance within LEDU over the relevant period. Responsibility for this must lie with LEDU's Senior Management and its Board, and also with the Department for deficiencies in their oversight of the former LEDU.

Action by Invest Northern Ireland and the Department

17. NIAO asked Invest Northern Ireland and the Department to summarise the action that has been taken in this case. The Department told us that it was deeply concerned at the shortcomings which the investigation had revealed in respect of the performance of the former LEDU prior to its abolition in 2002. Moreover, the Department recognised that, as indicated in the Memorandum of Reply to the Northern Ireland Assembly's report on the Northern Ireland Tourist Board[6], "there were deficiencies in the operation of the 'holding company' model, whereby NDPBs, while not being in any way independent units, were given a high degree of autonomy in the management of their day to day affairs within an agreed strategic framework". Significant lessons have been learned and applied from that experience and a range of actions has been undertaken by the Department including:

- the engagement of forensic accountants to conduct the investigation which dealt with complex issues;
- the establishment of a Steering Group comprising senior managers to oversee the handling of the investigation and the issues arising;
- the interim findings of the investigation were sent to the Chairman of EBT in July 2003 with a further list of issues being sent in November 2003[7];
- the taking of legal advice at various stages througout the investigation process;
- a meeting between the Chairman of Invest Northern Ireland and Mrs Townsley in December 2003 at which Mrs Townsley was asked, in the light of legal advice, to absent

6 Northern Ireland Department of Finance and Personnel Memorandum on the 1st Report from the Northern Ireland Public Accounts Committee, Session 2002-03, December 2002, HC 192.

7 The former Chairman of the EBT Board asked us to register, that he does not accept Invest Northern Ireland engaged in a satisfactory way with the EBT Board throughout the investigation.

herself from future meetings of the Invest Northern Ireland Board. Mrs Townsley did not attend any further meetings of the Board, and her term of appointment came to an end in March 2004 [8];

- Invest Northern Ireland held fourteen recorded meetings with representatives of the Board of EBT to discuss aspects of the investigation and proposed action to be taken;
- all relevant loan and venture capital funds have been reviewed in light of the issues identified in this case;
- the completion of a risk based inspection programme of the books and records of 28 TPOs, many of which were inherited from the former LEDU;
- relevant staff throughout the Department have been briefed on the issues arising from the review of TPOs;
- guidance has been produced and promulgated on the engagement and monitoring of TPOs;
- guidance on staff acting as directors of limited liability companies has been disseminated. This guidance reflects current companies and insolvency legislation and case law;
- The Department and its NDPBs are currently reviewing, on a case by case basis, the necessity for staff to act as directors;
- claims totalling £700,000 have been lodged with the Liquidator. The Department estimates that, if all claims are admitted by the Liquidator, between £170,000 and £250,000 will be recovered;
- the Department asked DFP to circulate this report to other government departments;
- a branch was established, in 2002, which specialises in corporate governance and accountability issues;
- risk management procedures have been strengthened, with Risk Registers prepared in the Department and its NDPBs;
- NIAO attend the Audit Committees of the Department, Invest Northern Ireland and the Northern Ireland Tourist Board;
- Departmental representatives sit on the Audit Committees of Invest Northern Ireland and the Northern Ireland Tourist Board;
- guidance has been issued on responding to NIAO reports and management letters. This involves Audit Committee follow up where appropriate;
- for 2006-2007, Statements of Internal Control will be required on a quarterly rather than annual basis from NDPB Chief Executives and from senior officers in the Department; and
- the Deparment has initiated a review of the relationship between the Internal Audit programme and the Risk Registers in the Department and in its NDPBs.

18. The Department has made the point that, as the events referred to in Invest Northern Ireland's investigation report occurred a number of years ago, they do not reflect the corporate governance arrangements now in place in the Department and its sponsored bodies. However, NIAO believes that there are lessons from this Report which will be of relevance to the wider public service.

8 Mrs Townsley's views on this issue are set out at Appendix 2.

Part 1

Conflict of Interest and Other Issues in the Establishment of the EBT Funds

Establishment of the EBT Loan Fund

1.1 The Loan Fund had its origin in a £1 million Pilot Loan Fund established by the International Fund in March 1994. The objective of the Pilot Loan Fund was to provide loans of between £5,000 and £50,000 to emerging businesses in disadvantaged areas of Northern Ireland. In March 1994 the International Fund, in consultation with the former LEDU, appointed MTF Chartered Accountants (MTF) as joint managers of the Pilot Loan Fund. MTF was a two-partner firm and one of the partners, Mrs Townsley, was a LEDU Board Member[9]. The other partner was her husband.

1.2 In their comments to the investigation on the origins of the Fund, MTF said that Mrs Townsley and a partner in another accounting firm[10] had been asked to write up a proposal for a small loan scheme following a meeting with the Department, the International Fund and LEDU representatives in December 1993. MTF said that: *"the Board of the International Fund together with senior civil servants in the Department considered the proposal and subsequently both firms were asked to take a role in the management and administration of the Pilot Loan Fund. The Pilot Fund was run by the Business Enterprise Programme team of the International Fund based at the Department of Economic Development at Netherleigh… It was not unusual at that time for known and respected individuals from firms to be asked to write and then operate pilot schemes in conjunction with government departments and organisations. There are frequent examples."* The Department told us that the Small Firms Loan Scheme emanated from the Board of the International Fund in the first instance. Board members responsible for overseeing the Business Enterprise Programme suggested that there was merit in testing such a concept. The Business Enterprise Programme team, on the direction of those Board Members, helped develop the concept and a paper outlining the rationale for a Pilot Scheme was subsequently prepared and submitted through the normal International Fund approval procedures for financial support – ultimately through the International Fund Board. This was the approval process which both the Small Firms Loan Scheme and the EBT proposal itself went through.

1.3 Although the initial appointment of MTF as managers had not been subject to competitive tendering, in 1996 the International Fund invited four organisations, including MTF and the former LEDU, to tender for the establishment of an independent and not for profit organisation to take over the Pilot Loan Fund's existing loan book.

1.4 The International Fund concluded that the MTF proposal was the best overall and that the LEDU proposal was a "poor second". However, it considered that the MTF proposal lacked the "solidity of a major public sector sponsor". The Board of the International Fund proposed that MTF and the former LEDU work together with the objective of producing a joint and agreed business plan that retained the best features of the MTF proposal while achieving "both the moral and financial commitment" of LEDU to the new organisation.

1.5 The former LEDU considered the proposal to be a worthwhile initiative to help small businesses. It agreed to provide funding to the new organisation and provided input to the International Fund and MTF on the make-up of the EBT Board.

1.6 A private company limited by guarantee[11] was established to run the loan fund. The company was registered in September 1996 as Emerging

9 Mrs Townsley was appointed to the former LEDU's Board in July 1993 and became Deputy Chair in December 1995. She was a Board Member of Invest Northern Ireland from its inception in April 2002 until March 2004.

10 FPM Chartered Accountants.

11 A company limited by guarantee does not rely on obtaining initial funding from its members, though its members guarantee payment of a minimum amount which need only be called upon after commencement of a winding-up of the company.

Business Trust (EBT Loan Fund). Mrs Townsley was appointed as a director and as company secretary.

1.7 A number of EBT Board Members have told NIAO that by the time they were appointed, the International Fund, the former LEDU and MTF had already agreed that MTF would be appointed as managers. They also emphasised that LEDU's involvement as a Government body and a source of expertise for small businesses, provided them with assurance that appropriate structures would be in place. Additionally, the Board Members took comfort from the appointment of a senior official, LEDU's Director of Corporate Services (subsequently Acting Chief Executive), alongside them on the Board of EBT. The International Fund also had a representative on the Board of EBT. EBT had no staff and was based in the same premises as MTF in Belfast.

1.8 The International Fund required, as a precondition of funding the EBT Loan Fund, that MTF would continue to manage the operation of the new organisation. NIAO accepts this but points out that this was not binding on LEDU. The International Fund drafted a management agreement setting out the activities to be undertaken by MTF, which included appraisal and monitoring of loans, promotion of the fund, and maintenance of accounting records. A second firm[12] of chartered accountants was appointed to assist MTF but its role was confined to carrying out loan appraisals. The intention was that having two firms undertaking appraisals would address conflicts arising in a situation where an application was received from a client connected to one of these firms.

Establishment of the EBT Venture Fund

1.9 In 1998, after two years of operation of the Loan Fund, MTF put forward a discussion paper on behalf of the EBT Board to the International Fund stating that the availability of venture funding for early stage technology companies in Northern Ireland was non-existent. The paper proposed setting up a Venture Fund.

1.10 In 1999, the International Fund accepted a proposal from the EBT Board to create a £1 million venture fund, with £0.5 million being provided by the International Fund. The Venture Fund would provide investment capital to start-up and growth companies in disadvantaged areas. Investments would be made in return for a share holding in client companies (an equity investment) or as a loan with an option to convert to shares. In 2000, the former LEDU agreed to contribute £0.25 million towards the Venture Fund. However, it did not consult the Industrial Development Board which was also sponsored by the Department and had considerably more experience in operating venture funds in Northern Ireland.

1.11 The EBT Venture Fund was established in June 2000 as a private company limited by shares. Its Board of Directors was the same as the EBT Loan Fund. The initial shareholding of the Venture Fund was for £3, held by three Board Members each holding a £1 share. Although there was not a formal trust agreement, the Chairman told NIAO that the intention was that the shares would be held in trust for EBT. Subsequently, the shareholding was widened to include the majority of the directors, the Loan Fund and MTF (see paragraphs 3.13 and 3.14). The Chairman also told us that in November 2004 eight of the ten directors transferred their shares in the Venture Fund to EBT and subsequently the remaining two directors transferred their shares in the same way.

The Findings of the Invest Northern Ireland Investigation

1.12 The investigation found a number of fundamental weaknesses in the establishment and appraisal of the Funds relating to:

- conflicts of interest arising from the governance arrangements (see paragraphs 1.13 to 1.25);

12 FPM Chartered Accountants

- failure to conduct an appraisal of the business case for the Loan Fund and weaknesses in the appraisal of the Venture Fund (see paragraphs 1.26 to 1.29);
- LEDU failed to ensure that its funding commitments to EBT were properly authorised (see paragraph 1.30);
- LEDU did not ensure the operation of proper tendering procedures (see paragraphs 1.31 to 1.34); and
- LEDU failed to draw up effective Letters of Offer (see paragraphs 1.35 to 1.39).

Conflicts of Interest Arising from the Governance Arrangements

1.13 Those appointed to serve on public bodies will be drawn from a variety of professional and business backgrounds and it is desirable that their skills and experience should be relevant to the body concerned. There will inevitably be occasions when there is the potential for conflict between the individual's private interests and the business of the public body concerned. There are, however, well established principles for identifying potential conflicts and either managing them or, if appropriate, avoiding them altogether. Northern Ireland departments are required to follow the guidance issued by the Office of the Commissioner for Public Appointments for Northern Ireland. Details of the current guidance are set out at Appendix 4.

1.14 The Nolan Commission's Seven Principles of Public Life (see Appendix 5) refer to conflicts of interest under Honesty: *"Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest."* Public perceptions are important in identifying a conflict of interest. A conflict need not necessarily mean that corruption has actually occurred. The key issue is whether there is a reasonable risk, to an outside observer, that the situation could undermine public trust and confidence in the official or the public entity.

1.15 The 1996 Treasury Handbook on Regularity and Propriety emphasises that avoidance of conflicts of interest in handling public money is a fundamental principle. It quotes a comment by the Chairman of PAC: *"Potential conflicts of interest are very serious matters indeed. We do not have to prove that something wrong has happened as long as the potentiality for that wrong doing exists…".*

1.16 It is important in dealing with any potential conflict of interest that there is proper disclosure, because transparency can help to allay public concern. However disclosure does not, in itself, avoid or solve a potential conflict although it does help to ensure that these are identified and can, therefore, be addressed.

1.17 In its report on The Proper Conduct of Public Business, PAC specifically identified the problem of failure to secure arm's length relationships with private sector consultants, leading to conflicts of interest in decisions to spend public money. It emphasised that: *"care should be taken to avoid actual, potential, perceived or perceivable conflicts of interest when employing consultants and staff"*. This proved to be a key failing in this case.

1.18 The investigation found that the former *"LEDU contributed to the formation of an organisation that stood to benefit an existing LEDU Board Member, as the EBT Loan Fund proposal included a provision that MTF would manage its operation".* This created a significant conflict of interest in that Mrs Townsley, a LEDU Board Member, became a Board Member of the EBT Loan Fund and, in addition, a firm in which she was a joint partner, MTF, was appointed as lead manager of the Fund. This situation arose despite the former LEDU being fully aware of the structure and operation of the Fund.

1.19 In keeping with the Loan Fund proposal, Mrs Townsley attended meetings of the Case Committee awarding loans, but did not participate in voting on funding decisions.

1.20 MTF told the investigation that: *"Mrs Townsley had clearly indicated to LEDU that she would be submitting a proposal to take the Pilot Scheme into the future. She was not part of the approval process of any support in LEDU and withdrew from the Board on any occasion that this came up for discussion. The structure of the Finance Committee in LEDU and its procedures would dictate that her involvement in EBT was minuted. The Finance Committee also had an observer from the Department who would have noted this. The support level to EBT would have required direct approval from the Department and also from the Department of Finance and Personnel. In addition, there was a Departmental representative at LEDU Board meetings who would have been privy to the details of this and would have reported to the Department if he was not content with proceedings in this regard. Furthermore the set-up of EBT was overseen by a senior official in the Department who was in contact with her on progress. The set-up of EBT was also monitored by the International Fund Board which includes US and EU advisers/observers."* The Department has told NIAO that it did not have an observer at meetings of the former LEDU Finance Committee; representation was confined to the LEDU Board.

1.21 The investigation found that the former LEDU wrote to Mrs Townsley agreeing proposals for the composition of the Board, but with one notable exception. LEDU stated that it could not endorse the inclusion of a senior partner in the subsidiary provider of management services[13] *"since he would be a delivery organisation to the company and hence a direct beneficiary".* The investigation commented that *"this appears to have been somewhat inconsistent given that LEDU apparently accepted the appointment of Mrs Townsley as a Board Member, even though she too would be in a delivery organisation to the company and stood to benefit directly as a partner of MTF, the lead manager of the new organisation".*

1.22 In 2000, conflicts of interest inherent in the structure of the Loan Fund were compounded when the same Board was appointed for the Venture Fund. In 2002, this was exacerbated when the majority of directors of EBT Venture Fund also became direct shareholders in the Venture Fund. The inherent risk in this arrangement was that if the EBT Loan Fund provided financing to companies in which EBT Venture Fund had already acquired shares, this could be perceived as a means of enhancing and/or protecting the directors' shareholdings.

1.23 The investigation found that an independent appraisal of the business case for the Venture Fund had clearly recommended in March 2000 that the Venture Fund Board should have a distinct membership from the Loan Fund. The independent appraisers stated *"the identity of the Venture Fund should be, and be seen to be, independent of the Loan Fund".*

1.24 It is not clear why this recommendation was not implemented but the investigation noted that Mrs Townsley challenged the appraisal stating *"the view that there is a potential for conflict of interest on whether to issue loan or invest is naive"*. The investigation found, as the independent appraisal had warned, a conflict of interest **did** arise in that the Loan Fund provided a loan to a company in which the Venture Fund already held shares (see paragraphs 2.7 and 2.9).

1.25 The former LEDU failed to ensure full disclosure of Mrs Townsley's roles in relation to EBT Funds in its own accounts. Mrs Townsley's membership of the Loan Fund and Venture Fund Boards was disclosed in the related parties note to the LEDU Annual Accounts as a 'non-beneficial interest'. However, reference to MTF's role in providing management services to EBT, or to a family member's connection to firms funded by the Venture Fund (see paragraph 2.6), was never disclosed in LEDU's accounts. The eventual disclosure was prompted by the Invest Northern Ireland investigation and NIAO's audit of the Invest Northern Ireland 2002–2003 Accounts. However, this did not appear until July 2004 when the Invest Northern Ireland Accounts were first produced. Mrs Townsley told NIAO that: *"as a member of the LEDU Board who declared all 'other' interests regularly in writing (including those of close family members),*

13 The senior partner in the subsidiary provider of management services told NIAO that he was not aware that his name had been suggested for membership of the EBT Board. He further added that he did not seek nor ever intend to sit as a Board member of EBT, consistent with his previous involvement with the International Fund's Pilot Loan Scheme.

Mrs Townsley understood in the external audit process and vetting of the accounts by the Department they would have ensured that the disclosure appropriate at that time was made. MTF were always identified as the Administrative Managers of EBT".

Failure to Conduct Proper Appraisals of the Business Cases

The Loan Fund Proposal

1.26 The former LEDU contravened its own procedures and failed to undertake an independent appraisal of the business case for the new Loan Fund, even though it was aware that Mrs Townsley was:

- Deputy Chair of the LEDU Board;
- a joint partner in MTF, which was to provide the management services;
- a promoter of the Fund; and
- to be appointed as a Board Member of the Fund.

1.27 The investigation noted that LEDU appears to have taken comfort from the fact that the International Fund had employed an independent consultant to provide advice in connection with transferring the pilot lending to the new EBT Loan Fund.

1.28 The investigation found that the former LEDU's three key criteria of admissibility, additionality and viability[14] were not fully considered by LEDU in its assessment of the business plans for the Funds. Specifically, the investigators noted that documentation was not available which clearly set out how each of the criteria had been satisfied. While they acknowledged that LEDU may have discussed the key criteria, they concluded that, in the absence of documentation, doubt exists as to whether due regard was given to safeguarding the proper use of public funds.

The Venture Fund Proposal

1.29 The investigation noted that the proposal for the Venture Fund did not outline how the initial costs relating to the Fund should be met. While funds provided by LEDU were to be used solely as venture capital, there was no provision within the proposal for costs to run the Fund. The investigation's opinion was that this was a failing within the proposal which may well have contributed to a situation whereby managers and directors of EBT Venture Fund took shares in lieu of fees (see paragraph 3.14).

LEDU Failed to Ensure that its Funding Commitments to EBT were Properly Authorised

1.30 The investigation has also registered possible concerns about the procedures to approve the £250,000 of financial assistance to the Venture Fund. The LEDU Finance Committee, which approved the assistance, met under the Chairmanship of the then Chief Executive in June 2000. However, the minutes record that one of the two Non-Executive Directors was absent, and there is no record whether he conveyed to the Committee any concerns he had about this case. In addition, the minutes note that one of the Executive Directors in attendance had been responsible for preparing the EBT Venture Fund submission. The investigation makes the point: *"although LEDU's Operating Manual does not preclude a Director from preparing a submission to a Finance Committee and sitting on the Finance Committee that approves the submission, it could be argued that the £250,000 operating grant to EBT Venture Fund may not have been approved by the Finance Committee in an appropriate manner, given that the quorum required in LEDU's Operating Manual was not present nor were the absent Board Member's comments minuted".*

14 The aim of the admissibility criterion is to establish that opportunities exist for the proposed product/service and to ensure the successful development of the project without the displacement of jobs in other similar local businesses. This concept is used by LEDU in place of the Government's Efficiency criterion which aims to ensure that a project strengthens the regional or national economy; it looks at the net economic benefits of the project, the displacement effect on other firms and the improvement in the company's performance. The aim of the additionality criterion is to ensure that the minimum amount of assistance is provided to any project to bring about the benefits associated with the project and that it will proceed in the manner intended. The aim of the viability criterion is to ensure that the business can sustain itself on an ongoing basis at the proposed level of activity without the need for further LEDU assistance.

LEDU Failed to Ensure the Operation of Proper Tendering Procedures

1.31 The former LEDU's involvement by providing financial assistance to the EBT Funds carried with it a responsibility to ensure that EBT had put in place appropriate and sufficient financial and other management controls necessary to safeguard public funds. However, the investigation revealed a concern about the absence of tendering.

1.32 The investigation found that the appointment, by the International Fund, of MTF as manager for both Funds was not subject to proper tendering procedures. In 1999, the EBT Loan Fund management services contract was renewed, without tendering, by the EBT Loan Fund Board. In 2002 the contract, which was by that stage for both Funds, was renewed for a further three years, again without tendering. NIAO noted that the 1996 draft Business Plan prepared by MTF for the Loan Fund envisaged that the managers *"will enter into a firm* ***continual*** [NIAO emphasis] *relationship"* with EBT. Mrs Townsley told NIAO that she absented herself from the EBT Board discussions on re-tendering.

1.33 The draft Business Plan relating to the establishment of the EBT Loan Fund estimated the provision of management and appraisal services at £855,000 over a three-year period. In the event, the actual management costs paid to Mrs Townsley's firm over the entire eight-and-a-half year life of the company was at least £1.4 million for both Funds. Payments to MTF are discussed at paragraphs 3.9 to 3.12. The absence of public tendering contravenes DFP's public procurement requirements and the EU public procurement rules. Contracts which are above certain thresholds – approximately £150,000 in the case of services – must be the subject of a call for competition by publishing a contract notice in the Official Journal of the EU.

1.34 The investigation found that appropriate safeguards were not insisted upon by the former LEDU to address potential conflicts of interest in the appointment of managers to the EBT Funds. Having failed to address the problem, LEDU compounded it by failing to insist that the basic safeguard of public tendering of the contracts was operated. The investigation concluded that: *"It would have been appropriate for LEDU to have insisted on the management contract for EBT Loan Fund and EBT Venture Fund being put out to formal tender. This would have ensured best practice in terms of public accountability, particularly given the fact that, at that time, Mrs Townsley sat on the Board of LEDU"*.

LEDU Failed to Draw Up Effective Letters of Offer

1.35 The investigation found three key deficiencies in the former LEDU's Letters of Offer to the Funds:

- there was no condition requesting proof of receipt of commercial funding;
- there was a lack of clarity surrounding LEDU's right to a return of funding in the event of the Funds ceasing to trade; and
- there were no specific details as to how the loans and investments would be monitored.

1.36 The draft Business Plan for the Loan Fund anticipated that, in addition to the public money provided by the International Fund and the former LEDU (paragraph 3), the Loan Fund would raise private funding of £1.25 million. However, this amount was never raised. The investigation noted that LEDU's Letter of Offer to the Loan Fund failed to incorporate a condition requesting proof of receipt of private funds prior to releasing instalments of grant. MTF commented that the commercial funding for the Loan Fund was an "*aspiration target*" and "*not a commitment of EBT or a precondition of any funding offer*". However, NIAO notes that it was a precondition of the International Fund's Letter of Offer that its funding "*form part of a package of public and private sector funding*".

1.37 In the case of the Venture Fund it was envisaged that, in addition to the public money of £750,000 to be provided by the International Fund and the former LEDU, the Venture Fund would raise private funding of £250,000. LEDU's Letter of Offer stated that, before payment of the first public funds instalment of £100,000, LEDU would require evidence that matching funding had been committed by the private sector. The £100,000 of private funding was never raised, however written commitments were provided to LEDU from the managers and directors for £50,000 and a company connected with one of the directors for £50,000.

1.38 The investigation noted that LEDU's Operating Manual did not allow for the indirect provision of capital grants or equity assistance to client companies through a TPO. The former LEDU resolved this difficulty by proposing that its funding of the Venture Fund would be channelled indirectly through the Loan Fund as a revenue grant and then invested in the Venture Fund. LEDU seemed to have assumed it could protect its right to recover its funding by enforcing the conditions in the Loan Fund Letter of Offer. Even this uncertain level of protection was not effective because, in the event, LEDU failed to follow the agreed indirect funding mechanism and the revenue grant was paid directly to the Venture Fund.

1.39 Other safeguards which the EBT Board could have established to protect its and LEDU's funding in the Venture Fund were not put in place. There was no separate shareholders agreement[15] when the Fund was established, although a draft agreement was prepared in 2002. In the absence of such an agreement, the Articles of Association should have contained, but did not, certain protections for the EBT Board such as the return of shareholdings on the retirement of directors.

There was no Written Contract for the Provision of Management Services

1.40 There was no signed contract between the Funds and MTF for the provision of management services. Services were provided on the basis of an unsigned management agreement appended to the International Fund's September 1996 Letter of Offer to the EBT Loan Fund. The investigation concluded that the nature and scope of the work undertaken by the managers of the EBT Funds, together with the value of the services, warranted a detailed legal contract.

15 A shareholders agreement contains the rules by which the ownership of a company is held. It provides a basis for the resolution of disputes; confirms the powers of the shareholders; and sets out the limits and procedures for how the company is to be operated.

The Department's Supervisory Responsibilities

1.41 We asked the Department, in exercising its supervisory responsibilities in relation to the former LEDU, what was the extent of its knowledge of the structure and activities of EBT. The Department told us that minutes of the 29 August 1996 LEDU Board meeting referred to the background to the formation of EBT, its relationship with LEDU and Mrs Townsley's involvement; and that the Departmental branch with responsibility for the former LEDU had sight of the November 1996 submission to LEDU's Finance Committee for funding of £250,000 to EBT in connection with LEDU's application for Departmental approval. The submission covers the creation of EBT by the International Fund to follow on from its own Loan Fund, the desire of the International Fund to have LEDU involvement in the company, the structure and the activities of EBT. It also contains the following in relation to conflicts of interest: *"The Managers will not have any direct handling of the loan funds. All payments will be made through the Appraisal Committee by the designated Board members other than the Managers' representative (ie Teresa Townsley). LEDU has agreed that the LEDU Board representative should also not have responsibility for loan payments, in order to avoid any potential conflict of interest."* With the invitation to participate in EBT, LEDU saw the creation of the Loan Fund as contributing to the achievement of its objectives in relation to enhancing economic activity within those areas perceived as disadvantaged, and how there was the potential for companies assisted by EBT to link with other LEDU programmes through the "aftercare" element. In addition the submission sets out LEDU's desire to input to the future strategic direction of EBT.

1.42 We also asked the Department how it had satisfied itself that proper controls and procedures were being operated within LEDU. The Department made a number of points:

- the Department required the former LEDU to operate under a control framework which encompassed, among other things, an Accounting Officer Memorandum, a Financial Memorandum, financial delegations and an operating plan cleared annually by the Department. The Department had an observer on the LEDU Board in the form of a Senior Civil Servant;
- the Department obtained assurances on the operation of proper controls and procedures within LEDU from the fact that LEDU's internal audit function was provided by the Department's Internal Audit Service. Internal Audit's annual activity culminated in the production of an annual report and overall audit opinion which was presented to LEDU's Chief Executive. The Chief Executive subsequently provided the Department with a summary of Internal Audit's annual activity and the overall audit opinion. In addition, the Accounting Officer was provided with a list of audits undertaken in all NDPBs by its Internal Audit Service;
- an Internal Audit report in June 1998 raised issues relating to administration fees charged to borrowers but found LEDU's monitoring arrangements to be adequate to fulfil their responsibility for overall management of the Seed Capital Fund; the contracted Agent's arrangements for the delivery of the Seed Capital Fund to be satisfactory; and that Agents were operating in accordance with the Fund Manual. Moreover, an independent evaluation of Seed Capital Funds in October 1999 found that "the systems and procedures operated by [EBT] could be viewed as a model of best practice" and that "EBT … has also been recognised by the Department of Trade and Industry and the European Investment Bank as a unique and efficient fund." The Department told NIAO that a degree of assurance seems to have been taken from these findings; and
- from 1998-1999 until 2001-2002, when LEDU ceased to exist, LEDU produced Statements of Internal Financial Control and Statements of Internal Control. These statements were included in LEDU's annual accounts which were subject to external audit and the Department took assurance from those Statements and the unqualified audit opinions that LEDU received from its external auditors.

1.43 NIAO notes that Mrs Townsley was a member of the former LEDU's Audit Committee and was appointed its Chair. Mrs Townsley was a member of the Departmental Audit Committee, in her capacity as Chair of the Health and Safety Executive for Northern Ireland Audit Committee (another Departmental sponsored NDPB). She was appointed in April 2002 and the Department told us that she attended three meetings. Her tenure of office on the Health and Safety Executive Board ended on 30 September 2003 and her representation on the Departmental Audit Committee ceased on that date. As the EBT investigation began in January 2003 there was some eight months overlap with her membership of the Departmental Audit Committee.

NIAO Comment

1.44 NIAO agrees with the investigation that the former LEDU failed to ensure that the structures for the Funds were appropriate. This contributed to the formation of an organisation that stood to benefit an existing LEDU Board Member. The combination of roles undertaken by Mrs Townsley in relation to EBT was inherently conflicting. She was LEDU's Deputy Chair, a Member of both the Loan Fund and the Venture Fund Boards and a partner in MTF Chartered Accountants who were the managing agents of both Funds.

1.45 NIAO recognises that those individuals who were approached to serve on the EBT Board undertook this as a public service and contributed their services for a relatively modest remuneration (see paragraphs 3.13 and 3.14). We agree with the views expressed by former

Board Members that they were entitled to take comfort from LEDU's involvement in shaping the structure of the Loan Fund and how it would operate, and in the appointment of a senior official, LEDU's Director of Corporate Services (subsequently Acting Chief Executive), alongside them on the Board of the Fund (see paragraph 1.7). However, the Department has made the point that under company law each of the Directors has a duty of skill and care to their company. The extent to which some or all of the Directors may have failed to exercise their duties to the company will be addressed by the Liquidator.

1.46 It is NIAO's view that the former LEDU must have been well aware of the conflict of interest in this situation, given that it had already objected to the appointment to the Board of a partner of the second company who was to provide management services. It should have been recognised that it was unacceptable for LEDU to endorse the much more serious perception of conflict of interest which involved its own Board Member. In NIAO's view, LEDU should not have committed public funds or agreed to LEDU representation on the EBT Board while these conflicts existed. It could be perceived that an opportunity was created through EBT to use public resources to enhance Mrs Townsley's private financial interest in MTF.

1.47 NIAO considers that the former LEDU could only have managed this particular set of conflicts of interest by ensuring that it did not arise in the first place. This failure was compounded by an extraordinary series of lapses:

- in contravention of its own procedures, LEDU failed to undertake an independent appraisal of the business case to establish the Loan Fund;
- an independent appraisal of the business case for the Venture Fund was undertaken, but LEDU did not ensure that the consultant's recommendation that there be distinct Boards for each of the Funds - which would have avoided one of the conflicts of interest - was implemented. Moreover, Mrs Townsley was personally involved in rebutting the consultant's recommendations;
- the normal public sector rules on competitive tendering were not insisted upon and the contract for management services was awarded on a three-year rolling basis to MTF. This, in particular, has left LEDU not well placed to defend itself against allegations of favouritism towards a firm jointly owned by a LEDU Board Member and her husband;
- it is a core function for a body such as LEDU, making grants and loans of taxpayers' money, to issue effective Letters of Offer to protect the public funds involved. This was not done in the case of EBT. LEDU failed to ensure that its Letters of Offer covered such basic matters as obtaining proof that the conditions of funding were met. LEDU also failed to ensure that the Letter of Offer providing £500,000 of funding to the Loan Fund contained effective clawback clauses;
- LEDU failed to make full disclosure of Mrs Townsley's role in relation to EBT Funds in its accounts. In NIAO's view early disclosure would almost certainly have attracted sufficient attention to ensure that the conflict of interest issues had to be addressed;
- LEDU's Operating Manual did not permit capital grants or equity to be paid through a TPO. However, to facilitate the Venture Fund, LEDU proposed to employ an indirect payment mechanism which was intended to circumvent this restriction. In NIAO's view this type of creative funding, which was intended to circumvent its own operating rules, is improper in a public body; and
- LEDU's Finance Committee approved assistance to the Venture Fund although the quorum required was not present. In addition, the Director who prepared the submission recommending LEDU funding had a seat on the Finance Committee which approved it.

Part 2

Conflicting Relationships and Transactions between Managers and Companies Assisted by the Funds

2.1 Part 1 of this Report examined the failure of the former LEDU to deal effectively with inherent conflicts of interest, involving its Deputy Chair, when the Loan and Venture Funds were set up. This part of the Report deals with a range of conflicting relationships, transactions, and personal interests between the two firms appointed as managers of the Funds and companies assisted by the Funds.

2.2 The former LEDU did not communicate the existing good practice guidance to the EBT Boards on how to deal with conflicts arising from the relationship between the managers and client companies. The draft Management Agreement between MTF and EBT, issued under the International Fund's September 1996 Letter of Offer, was also silent on how conflicts of interest should be handled.

The Role of the Company Secretary in Dealing with Conflicts of Interest

2.3 Mrs Townsley acted as company secretary for both EBT Loan Fund and EBT Venture Fund from their establishment. The Company Secretary has responsibility for advising the Board, through the Chairman, on governance matters. Boards of Directors have a right to expect the Company Secretary to give impartial advice and to act in the best interests of the company.

2.4 MTF told the investigation that in dealing with conflicts of interest, Mrs Townsley and MTF followed the guidance as set out in the Code of Practice issued by The Commissioner for Public Appointments which states: *"holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest"*. MTF added, *"Full disclosure of any material facts was always made to avert any potential for conflicts"*.

2.5 The former Chairman of EBT told NIAO that he had an accepted policy of asking any directors whose activities presented a possible conflict of interest to absent themselves from the meeting. EBT had a policy that anyone with direct commercial involvement would take no part in decisions.

EBT Venture Fund Invested in Companies in which Mr Townsley already held Shares

2.6 By September 2003 the EBT Venture Fund held equity investments in ten companies. The investigation found that Mr Townsley was Director of, and shareholder in, two of these companies – Arcom Multimedia Limited (Arcom) and Fusion Antibodies Limited (Fusion) - prior to the EBT Venture Fund investment. The investigation noted that in both instances Mr Townsley's share holdings were acquired in the period between the date the Venture Fund investment was approved and the date the investment was completed. EBT Venture Fund also considered an equity investment in a third company, Genomic Mining Ltd. Mr Townsley was a Director and shareholder in this company and Mrs Townsley was the company secretary. However, in this case the investment did not proceed. The Department told us that LEDU/Invest Northern Ireland had provided direct financial support to Arcom and Fusion of £74,000 and £30,000 respectively.

The Relationship between MTF and Arcom

2.7 It could be perceived that MTF had developed a separate relationship with Arcom arising from the Pilot Loan Fund and Loan Fund applications. This subsequently led to MTF acting as consultants to, and accountants for, Arcom at various times between 1995 and 1999. The relationship with Arcom led to Mr Townsley being offered shares in the company in August 1999; an offer which he asked to be put on hold. The relationship between MTF, Mr Townsley and Arcom was not disclosed to the EBT Board when, in October 1999, Arcom applied for and MTF recommended a loan of £20,000. The loan was issued in December 1999.

2.8 Mr Townsley's investment in Arcom was later disclosed to the EBT Board in October 2000; he became a director and purchased a 10 per cent share in November 2000. In order to deal with the disclosure of Mr Townsley's interest, the EBT Board designated one of its non-executive directors to provide an independent overview in relation to Arcom.

2.9 Mr Townsley purchased 10 per cent of Arcom for £2,500 in November 2000, each share costing £1.08. Previously in April 2000, the Board of the EBT Venture Fund had approved in principle the purchase of a 10 per cent share in the company for £50,000, each share costing £19.49; this transaction was actually completed in March 2001. The investigation comments: *"The fact that Mr Townsley invested in shares in Arcom when he was aware of the potential investment by EBT Venture Fund at a substantially higher value gives cause for concern".*

2.10 MTF continued to be involved in monitoring EBT investments in Arcom. In December 2002, Mrs Townsley recommended to the Board's Casework Committee an additional fast track loan of £25,000 to Arcom. This was despite Arcom's draft financial statements and management accounts showing that the company was in financial difficulties. The loan was made in February 2003. Arcom went into liquidation in September 2003 with probable aggregate losses of £100,000 to the Loan Fund and Venture Fund. Mrs Townsley told NIAO that: "*the update report presented to the case work committee on which the decision to provide a further loan was prepared (with recommendation) by the designated non-executive director* (see paragraph 2.8) *who had been liaising and meeting with Arcom. Mrs Townsley's function was administrative. The risks of the sector and in particular the company at that time were considered by the EBT Board. In recognition of this and the lack of security, the EBT Board recommended the loan be made by way of the Small Firms Loan Guarantee Scheme*[16] *whereby EBT were guaranteed some 85 per cent of the loan by the Department of Trade and Industry.*"

2.11 There was also a business relationship between Arcom and Disorder Digital Media, a subsidiary of MTF Technology Ltd, of which Mr and Mrs Townsley were shareholders and directors. This relationship was not disclosed to the EBT Board at any time. Mrs Townsley told NIAO that: "*there was an arms length trading relationship with a subsidiary programme of the training division of MTF (separate company). This was not believed to be material to be disclosed. Both Arcom and this company declared the trading relationship in their accounts.*"

2.12 The investigation was advised by MTF that Mrs Townsley continued to be involved in monitoring Arcom and in processing the new loan because the EBT Board "*considered it part of Mrs Townsley's work to regularly update the Board on progress with the individual investments*" and that the update on Arcom *"would have been overseen by the designated Board member*".

2.13 MTF told the investigation that Mrs Townsley was not aware of the extent of Mr Townsley's involvement with Arcom. MTF said that a formal relationship had existed between MTF and Arcom "*from about June 1996 to early 1998*" but it did not exist at the time EBT Loan Fund agreed to assist the company in October 1999.

2.14 The investigation takes the view that whether or not a "formal" relationship existed is not the key issue: *"…the overriding issue is whether or not a relationship existed which would give rise to a perceived or actual conflict of interest. This does appear to be the case."*

16 The Small Firms Loan Guarantee Scheme is a joint venture between the Department of Trade and Industry and a number of participating lenders. The scheme provides lenders with a Government guarantee against default in certain circumstances.

The Relationship between MTF and Fusion

2.15 Mr Townsley was also a co-founder, Finance Director and a major shareholder in Fusion. His shareholding was acquired in the period between the Venture Fund approving an initial investment (bridging loan) of £25,000 and a further investment of £50,000 being approved in February 2003. This further £50,000 investment in Fusion was completed in April 2003. MTF had referred Fusion to the Venture Fund and prepared its Business Plan. However the appraisal was not undertaken by MTF. According to Company Registry records, as at May 2005, Mr Townsley owned 17 per cent of ordinary share capital of Fusion, EBT Venture Fund owned 5 per cent, Invest Northern Ireland's own Venture Fund (Nitech Growth Fund) owned 4 per cent and another Departmental sponsored Venture Fund, known as Viridian Growth Fund, owned 8 per cent. In addition Qubis Ltd (a technology transfer company which engages in commercial exploitation of the academic and research activities of the Queen's University of Belfast) had a 4 per cent stake.

2.16 MTF told the investigation that the EBT Board had been aware from the outset that Mr Townsley was a co-promoter of this company. MTF said: "*This was reinforced by a presentation to the Board by he* [Mr Townsley] *and his co-promoter on 10 September 2001 prior to the investment in the company by EBT. It was well known that Mr Townsley prepared the business plan for the company. Mrs Townsley took no part in the decision process.*" MTF added, "*Following approval at Board of this investment, EBT became an investor of this company on the same terms as 'family and friends'. This initial investment in ordinary capital was recently confirmed as having a value approximately 21 times higher than its initial cost. Fusion has been formally recognised as a leading innovator of new technology through the All Ireland Innovation Awards and would be considered to be at the forefront of its field. EBT Board would consider this one of its best portfolio investments.*"

The Relationship between MTF and Genomic Mining Limited

2.17 EBT Venture Fund considered a £50,000 equity investment in Genomic Mining Limited. Mr Townsley was a Director and shareholder of this company and Mrs Townsley was the company secretary. The investigation noted that the subsidiary provider of management services was the company's auditors, which could explain why it was not asked to conduct the company appraisal. The investigation was advised that the application went to the Case Committee on 27 February 2002 without a recommendation or external appraisal. In the absence of an external appraisal, Mrs Townsley "*wrote up the case*". In November 2002, Genomic Mining Limited contacted Mrs Townsley to indicate that it was unlikely to proceed with the investment. No investment was made.

Extent to which those Firms Appointed to Manage the Loan Fund Introduced their Own Clients to the EBT Loan Fund

2.18 As the following extract shows, the investigation found a range of potential conflicts of interest where the managers had introduced existing clients of their firms to EBT Loan Fund and EBT Venture Fund. In some cases the managers had also assisted in the preparation of business plans or other financial information which was used to support applications for financial assistance, which they had then appraised.

Extract from paragraph 299 of Invest Northern Ireland's Report of November 2005 on the Investigation into the Establishment and Operation of the Emerging Business Trust Loan Fund and the Emerging Business Trust Venture Fund.

Potential Conflicts with Client Companies

However, during the course of our review of the EBT Loan Fund and the EBT Venture Fund case files we identified a number of further potential conflicts of interest. Our understanding is summarised as follows:

- Company A was provided with a £15,000 loan by the EBT Loan Fund on 8 September 1999. This company was referred to the EBT Loan Fund by FPM. FPM also assisted Company A in the preparation of financial information to support the loan application. The application was appraised by FPM[17].
- Company B was provided with a £20,000 loan by the EBT Loan Fund on 16 October 2001. In May 1999 MTF helped this company prepare a business plan….. MTF appraised the application to the EBT Loan Fund, which was supported by an updated version of the business plan. Following MTF's appraisal, the loan was approved by the Case Committee on 8 November 1999.
- Company C was provided with a £15,000 loan by the Pilot Loan Fund in November 1995 and a further £5,000 loan by the EBT Loan Fund on 17 September 1998. MTF appraised the Pilot Loan Fund application in 1995 and subsequently helped the company formalise its business plan in January 1996. In 1996 the company also became a client of MTF, but moved to other accountants in August 1997. MTF appraised the application to the EBT Loan Fund. The company defaulted on payment in November 1999 and an amount of approximately £11,000 was written off in June 2001.
- Company D was provided with a £10,000 loan by the EBT Loan Fund on 23 January 1998. It appears that, prior to the submission of the company's application form, MTF had assisted the company in the preparation of financial information in support of the application. MTF appraised the application when it was submitted. Subsequent to appraisal of the £10,000 loan, MTF prepared a business plan for the company which appears to have been grant aided by LEDU.
- Company E was provided with a £20,000 loan by the EBT Loan Fund on 9 November 2000. The company is a client of FPM and the company's business plan was prepared by FPM. The application to EBT Loan Fund was appraised by FPM although we have been advised that the appraisal was not performed by the individual who completed the business plan or normally deals with the client[18].
- Company F was provided with a £20,000 loan by the EBT Loan Fund on 14 April 2000 and a £20,000 Fast Track Loan on 19 March 2002. Company F was a client of Arcom in which Mr Townsley became a director and shareholder in November 2000. We have been advised that Company F was referred to the EBT Loan Fund by a director of Arcom; however the file records the referral source as MTF. MTF appraised the original loan application in January 2000. The Fast Track loan application was also appraised by MTF, even though Mr Townsley at this point in time was a 10 per cent shareholder in Arcom, a customer of Company F. On 2 July 2002, Company F received a bridging loan of £20,000 [from the EBT Loan Fund]. On 2 September 2002 an equity investment of £40,000 [from the EBT Venture Fund] was agreed that included some of the existing loans being converted to equity. It would appear that MTF appraised the equity application. We understand that a four month moratorium on loan repayments was allowed from October to January 2002. However, no further repayments were made subsequent to this, resulting in an outstanding balance of over £21,000 as at 31 August 2003.
- Company G was provided with a £20,000 loan by the EBT Loan Fund on 31 October 1997 and a further loan of £5,000 on 1 May 1999. The original loan application was submitted in June 1997, together with a business plan prepared by its accountants. The application was appraised by MTF and all conditions were satisfied on 27 October 1997. By this date, it appears that MTF had begun to assist the company to prepare a business development plan. In February 1999, MTF assisted the company in a business review. MTF appraised the further loan of £5,000 in April 1999. In April 2000 the broad terms of an equity investment were agreed and a bridging loan approved. By 2001, the directors of Company G stated that they no longer wished to complete the equity investment and the bridging loan was repaid in full. On 8 April 2002, a further Fast Track loan of £15,000 was provided.

17 FPM Chartered Accountants told NIAO that it had highlighted and disclosed its previous involvement with Company A to EBT.

18 FPM told NIAO that it only undertook this assignment due to exceptional circumstances concerning the non availability of Mr and Mrs Townsley due to other commitments. It was agreed that the appraisal would be subject to a further review prior to submission to the EBT Board.

2.19 Invest Northern Ireland is not aware of any other companies with loans or investments written-off which had an association or commercial relationship with MTF, other than those already outlined in its investigation report.

2.20 MTF told the investigation that it was *"frequently asked to quote for business development work from a variety of companies. If the managers were asked to quote by EBT client companies then it was not considered unreasonable to do so and this was not forbidden."* MTF added *"EBT/EBT Venture Fund Boards considered some 426 appraisals of the 1,471 applicants and it is estimated that MTF carried out consultancy assignments with probably 13 of the businesses over the eight year period, excluding Fusion and Arcom. This 13 included five MTF accounts clients (pre December 1999). The large majority of these assignments were gained from a bid process. A marginal revenue was returned from this for the practice."*

NIAO Comment

2.21 NIAO agrees with the investigation's conclusion that significant conflicts of interest existed in the relationship between MTF and a number of client companies of EBT. These should have been avoided. Where disclosures were made they were not well handled. The Department told us that the EBT Board had a responsibility to ensure that it had formal procedures in place to identify and properly deal with conflicts of interest. While the EBT Board had some measures in place to deal with conflicts of interest including the arrangement where an accounting firm other than MTF could do appraisals, these controls were insufficient to deal with the full range of conflicts of interest scenarios that arose in this case.

2.22 There are a number of lessons arising from this case:

- the former LEDU should have recognised at the outset the importance of avoiding the perception that existing clients of EBT's managers, or parties with connections to the managers, might have preferential access to a scheme designed to assist business starts in disadvantaged areas of Northern Ireland. In view of the risks involved, it is disturbing that LEDU's Letters of Offer were completely silent on how potential conflicts of interest between the managers and EBT client companies should be handled;
- LEDU, as a condition of funding, should have strictly forbidden managers from holding shares and directorships in EBT companies; and
- EBT's managers should have been forbidden from supplying auditing, accounting, management consulting and other financial services to EBT client companies. In NIAO's view this was an area which demanded strict regulation in order to ensure that the managers' investment advice to the EBT Board was completely independent and objective and seen to be so.

2.23 This case illustrates the dangers of using an accountancy firm with its own client base to provide management and appraisal services to financial institutions funded from public sources, without first ensuring that robust procedures were in place for dealing with the almost inevitable conflicts of interest that arise in such an arrangement.

Part 3

Performance of the Funds

The Loan Fund was not Self-Perpetuating

3.1 The financial target for the Loan Fund was to reach a value of £5 million over a three year period, which would enable it to be self-perpetuating. The initial value of the Loan Fund was £3.5 million in capital funds provided by the former LEDU and the International Fund. By 2004, despite earning £1.4 million in bank and loan interest and fee income and receiving £600,000 in funding to establish the Venture Fund, the value of the Loan Fund was only £2.7 million. The investigation concluded that "*the funds made available to the EBT Loan Fund have been substantially depleted….due principally to the level of management fees and bad debts*". Table 3.1 sets out the sources of funds to the Loan Fund between 1997 and 2004[19] and shows how funds have been applied.

Loan Fund Levels of Bad Debt were High

3.2 By March 2004 bad debts arising from loans amounting to some £1.1 million had been written-off by the EBT Loan Fund. Almost 60 per cent of bad debts (£646,000) related to loans issued by the Pilot Loan Fund, to which LEDU had made no contribution. Mrs Townsley told NIAO that "*EBT had inherited the Pilot Loan Fund from the International Fund. The International Fund had made the lending decisions and the decision to allow 'soft' security taken, if at all. This made recovery of defaulters difficult.*" Table 3.2 shows the increasing levels of bad debt between 1997 and 2004. In 2001 alone, bad debts of £331,000 were written off. This amounted to 28 per cent of the value of loans at the end of that year.

3.3 The investigation found the accounting treatment of bad debts on loans awarded during the life of the Pilot Loan Fund was: "*…incorrect and not in accordance with generally accepted accounting practice*". The effect of this has been to understate the level of loss in the Loan Fund accounts. Actual

19 Figures to September 2002 are based on audited accounts; those for the 18 months to March 2004 are based on draft accounts prepared by EBT.

Table 3.1: EBT Loan Fund - Movement in Funds 1997-2004

Source of Funds:	**£000**
The International Fund: Capital Funding	 3,000
LEDU: Capital Funding Revenue Funding	 500 250
Grants for Venture Fund	600
Loan Interest Earned	755
Client Arrangement Fee Income	89
Bank Interest Earned	510
Other Income	26
Total Source	**5,730**
Application of Funds:	
Management Fees	1,272
Sundry Costs	653
Bad Debts: Pilot Fund Loan Fund	 646 461
Total Application	**3,032**
Fund Balance at 31 March 2004	**2,698**
Balance made up of: Fixed Assets Cash Loans Debtors: Venture Fund Other Debtors Creditors	 3 991 1,033 871 120 (320)
Total Balance	**2,698**

Source: Invest Northern Ireland Investigation

Table 3.2: EBT Loan Fund - Levels of Bad Debt 1997-2004

	1997 £000	1998 £000	1999 £000	2000 £000	2001 £000	2002 £000	2003/4 £000	Total £000
Value of Loans – at year end	2,001	2,088	1,791	1,554	1,185	1,360	1,033	-
Bad Debts in year:								
Pilot Loan Fund	89	87	74	98	271	11	16	646
EBT Loan Fund	5	25	39	111	60	47	174	461
Total Bad Debt	**94**	**112**	**113**	**209**	**331**	**58**	**190**	**1,107**

Source: Invest Northern Ireland Investigation

losses for the seven-and-a-half years ending March 2004 were £1.4 million, rather than the £0.76 million reported. The Department explained that, although EBT Loan Fund bad debt was 12 per cent, it is recognised that lending to small firms, particularly those operating in areas of disadvantage, is a high risk activity. For instance, the Small Firms Loan Guarantee Scheme for the Department of Trade and Industry reported a bad debt rate on its portfolio at 31 March 2004 of around 20 per cent[20].

3.4 NIAO understands that the volume and value of loans issued was lower than planned. The former Chairman of the EBT Board told Invest Northern Ireland that: "*the Board by 2000 had assessed that the market for low cost loans had changed and the viability of the concept was being eroded, or had already been eroded, by market forces*".

Loan Fund Management Costs were Significant

3.5 The investigation found that a significant proportion of the funds available to the EBT Loan Fund had been applied in meeting its running costs. The total cost of administering the EBT Loan Fund for the period between 1997 and 2004 was £1.9 million. Of this, £1.2 million related to management fees, representing 20.3 per cent of the initial value of the Loan Fund. Management fees paid to MTF[21] (at least £1.1 million) are analysed in further detail at paragraphs 3.9 to 3.11. The investigation concluded that bad debts and management costs "*…are significant and result in a substantial reduction in the level of funds available for loans*".

Other Factors Influencing the Performance of the Loan Fund

3.6 In addition to the high level of bad debt and the significant cost of management fees, two other factors are relevant to the performance of the EBT Loan Fund:

- **£1 million of Loan Fund held in Bank**
  The investigation found that, on a consistent basis, approximately £1 million of the Loan Fund had been kept on deposit at the bank, earning interest of £510,000. This capital was not therefore utilised to make loans; and

- **Loan Fund failed to receive Funding from the Commercial Sector**
  The former LEDU and the International Fund paid the Loan Fund £3.75 million funding. The balance of the £5 million fund (£1.25 million) was to be raised by EBT from commercial sources. No commercial funding was ever received (see paragraph 1.36).

20 Final report of the Graham Review of the Small Firms Loan Guarantee Scheme, September 2004.

21 The investigation found that actual payments to MTF between 1997 and 2003 were £1,085,000. They would also have received a substantial part of the management fees paid between September 2003 and March 2004. However, these are not separately identifiable in the draft accounts for the 18 months to March 2004.

There are Doubts as to Whether the Loan Fund Management Fees provided Value for Money

3.7 The investigation did not constitute a detailed value for money assessment but it did consider the relationship between the overall administration costs and fees and the total funding disbursed. The investigation concluded that administration costs (£1.9 million) of the EBT Loan Fund appeared high in relation to the costs that would be incurred by a commercial organisation. However, they do not appear to be markedly out of line with the level of costs incurred in the delivery of other publicly funded programmes.

3.8 The investigation noted that the greater part of the management fees related to loan management costs and not the costs associated with delivering the funding in the first instance. The investigation concluded that given the level of bad debt (paragraph 3.2), the delay in providing for bad debts (paragraph 3.18) and the lack of evidence of provision of aftercare (paragraph 4.8): *"There is an element of doubt as to whether the loan management fees* [which amounted to £760,000] *paid by the EBT Loan Fund constitute value for money."*

Fees and Other Payments to MTF

EBT Loan Fund Payments to MTF

3.9 MTF received almost £1.1 million in fees from the Loan Fund in the seven years to September 2003. Table 3.3 provides an analysis of the payments.

EBT Venture Fund – Management Fees

3.10 The management fee for the Venture Fund was calculated on the value of bridging loans issued to clients and subsequently on the cost of equity investments made. In addition, payments to MTF were also in respect of bookkeeping, accountancy, equity appraisal costs and consultancy. Total payments to MTF from the EBT Venture Fund were £144,700 which represents 24 per cent of the total capital funding paid to the Venture Fund.

Table 3.3: Loan Fund Management Fees paid to MTF between 1997 and 2003

Service	£
Bookkeeping and Accounting	41,500
Loan Application Processing	80,400
Loan Appraisal Fees	182,700
Loan Management Fees	760,400
Consultancy	9,500
Other	10,100
Total	**£1,084,600**

Source: Invest Northern Ireland Investigation

3.11 Invest Northern Ireland told us that it had been advised by the Liquidator of EBT that payments amounting to £163,000 were made to MTF during the period from September 2003 to April 2005. Therefore the total payments to MTF from the Loan and Venture Funds were £1.4 million.

3.12 The investigation raised concerns about a number of additional payments to MTF, on top of the monthly management fee, for services which were not included in the Loan Fund and Venture Fund proposals. These include costs such as bridging loans, letters of offer, preparation of bridging loan security, negotiation of pricing agreements and completion of various returns for the Venture Fund. The investigation was also concerned that the EBT Loan Fund made a contribution to MTF's own insurance costs. The Loan Fund also engaged a public relations firm, although MTF was responsible for promoting EBT under the management agreement. These additional payments are covered in detail at Appendix 6. Mrs Townsley told NIAO: *"All fees to MTF were agreed in advance by the Board of EBT, based on specific elements of work requested and measured by the work done. The EBT Board engaged a public relations firm to increase the external profile of EBT, not to replace the work MTF was contracted to do in this area. This was a Board decision"*.

Payments to Directors of the Funds

3.13 The investigation reviewed payments to the EBT Loan Fund Board and concluded that they did not appear to be excessive. Eight of the ten directors received a remuneration and were also paid for attending Case Committee meetings. The total remuneration paid between 1997 and 2002 was £44,307. In addition, the directors were paid £76,200 for attending Case Committees over the same period. In aggregate, this amounts to an average of £2,511 per director per annum. The LEDU/Invest Northern Ireland representative on the Board and Mrs Townsley received no payment for their role as directors.

3.14 The directors were entitled to directors' fees of £4,000 per annum for the Venture Fund with the Chairman entitled to £6,000 per annum. Eight of the ten (again excluding the LEDU/Invest Northern Ireland representative and Mrs Townsley) received shares[22] in the Venture Fund in lieu of salary in December 2002 (see paragraph 1.22). At the same time, MTF was allocated 10,000 £1 ordinary shares in the Venture Fund in lieu of management fees. The former Chairman of EBT told NIAO that two non-executive directors had formally declared that their shareholding was not for personal benefit and was simply a means of offsetting the non-payment of fees. This declaration was later endorsed by all other current directors who transferred their share entitlement back to EBT (see paragraph 1.11).

EBT Venture Fund - Employment of Funds and Performance

3.15 The investigation concluded that it was still too soon to judge the performance of the EBT Venture Fund. This could only be done by a valuation of the Venture Fund's portfolio which had not yet been undertaken[23].

22 The Chairman received 6,000 £1 ordinary shares and the other seven directors 4,000 £1 ordinary shares.

23 The draft Accounts for 2003-2004 show the value of investments at 31 March 2004 at £564,500. This reflects cost price less write-offs and is not an up-to-date valuation.

3.16 EBT Venture Fund had failed to achieve its targets in terms of:

- **raising capital of £1 million by August 2002** including £250,000 from private investors. Apart from shares issued to directors and MTF in lieu of fees (paragraph 3.14), no direct private investment as envisaged was made in the Venture Fund, although commitments to invest totalling £100,000 had been provided to LEDU in writing by the managers and directors of EBT Venture Fund, and by a company connected to one of the directors; and
- **making 18 investments by March 2003** – ten investments had been made by September 2003. By April 2005 a total of 14 investments had been made by the Venture Fund.

Performance against the Management Agreement

3.17 The investigation revealed a number of concerns about the level of services provided by MTF under the 1996 management agreement (see paragraph 1.8) particularly regarding the provision for bad debts.

Delays in Bad Debt Provision

3.18 The investigation reported a "considerable delay" in providing for bad debts. For example, 58 per cent of the loans recognised as bad debts in 2001 had not received any loan repayments for more than two years prior to being written-off.

3.19 MTF received a management fee of £50 a month for each loan managed, based on the number of loans included in the debtors' ledger at the end of each month. However, a number of loans remained on the debtors' ledger, although they had been written-off in the financial statements. The investigation found that, if these loans had been removed from the ledger more promptly, the EBT Loan Fund could have saved substantial loan management fees (based on an analysis of the debtors files as at 31 August 2003, a £64,000 saving could have been made if loans were removed 12 months after the date the last repayment was received). Mrs Townsley has provided further material on this matter at Appendix 2.

3.20 The investigation also reviewed loans which had not been written-off in the financial statements and found that if these also had been written-off 12 months after the last repayment, EBT Loan Fund could have saved a further £13,000 in management fees.

3.21 The investigation found that the EBT Loan Fund did not have a formal written policy for the recognition, provision for and write-off of bad debts, although there were procedures for pursuing outstanding loans.

Other Services Provided under the Management Agreement

3.22 The investigation raised a number of other concerns about services provided by MTF. The EBT Funds Boards did not appear to receive sufficient regular information, for example on turnover and profitability, which the investigation felt would be necessary in order to adequately monitor the performance of the Loan Fund, the Venture Fund and their clients. However, the Chairman of EBT told the investigation that information of this kind was received, at least orally, by the Venture Fund Board and the Loan Fund Board had an explicit policy of asking the managers to only make negative reports.

NIAO Comment

3.23 The evidence provided by the investigation demonstrates that the performance of the Loan Fund has been poor in the following areas and, as a result, the Fund was not self-perpetuating:

- there was a high level of bad debt - in total, £1.1 million of loans made by the Fund were written-off;
- bad debts were poorly managed. The Loan Fund paid MTF a significant amount of loan management fees which could have been avoided if the loans had been written-off on a timelier basis. It is of concern that the fees were incurred because the debtors' ledger, maintained by MTF, was not consistent with the accounts;
- the Loan Fund did not attract any of the commercial funding (£1.25 million) envisaged; and
- total fees of £1.4 million were paid to MTF between 1997 and 2005 of which £760,000 related to loan management. The investigation found, and NIAO agrees, that given the significant failings in loan management, there are doubts as to whether fees of £760,000 represent value for money.

The investigation also showed that the Venture Fund never raised any direct commercial funding.

3.24 The allocation of shares to Directors and MTF in lieu of management fees increased the potential for conflicts of interest and is not a good model to follow in any public body funded wholly by public money where independence and transparency are important (paragraph 3.14).

3.25 The low demand for EBT loans was one of the factors influencing the performance of EBT Loan Fund. In NIAO's view the lack of demand calls into question whether the Fund should have continued in operation for eight-and-a-half years (paragraph 3.4).

3.26 It is surprising that, in order to safeguard public funds, the EBT Board did not ensure that a Loan Fund such as EBT which, by its nature, would inevitably be involved in some higher risk lending, did not have a proper written policy for handling the write-off of bad debt (paragraph 3.21).

Part 4

Adequacy of LEDU's Monitoring Regime

4.1 The investigation identified a wide range of basic failings in the former LEDU's monitoring of the payments it made to fund the EBT Loan Fund and EBT Venture Fund. The amounts paid to EBT under each of the Letters of Offer made by LEDU and the International Fund are set out in Table 4.1.

Inadequate Vouching of Payments and Monitoring of the Funds

4.2 The investigation found little or no evidence of proactive monitoring of the Funds after the first instalment of grant was paid.

4.3 The former LEDU stated that it was satisfied that the first instalment of grant to the Loan Fund had been used in accordance with the September 1996 Letter of Offer. However, the detailed information required on performance was never provided.

4.4 The former LEDU stipulated that the Loan Fund grant should be vouched *after* the second (and final) instalment under the September 1996 Letter of Offer had been made. The investigation reported: *"…it seems somewhat concerning that the vouching process was to be done after the second tranche of monies was paid. We would have expected such a process to be done in advance of additional monies being paid."* A LEDU Grant Inspector visited EBT on 12 August 1997 and reported that its records were well kept and up-to-date.

4.5 The investigation shows that, in August 1997, the former LEDU became aware through the visit of its Grant Inspector that the EBT Loan Fund held over £1.2 million in its bank account. Despite the fact that substantial sums of money were not being used, LEDU paid the second and final instalment of £125,000 under the March 1997 Letter of Offer.

4.6 The investigation found the information held by the former LEDU was insufficient to establish that the conditions of the October 2000 Letter of Offer for the Venture Fund had been fully met, for example, no quarterly reports required by the Letter of Offer have been retained on LEDU's vouching payments file.

Table 4.1: LEDU and the International Fund grants to EBT Loan Fund and EBT Venture Fund

Letter of Offer	Description	Amount Offered £ million	Amount Paid £ million
The International Fund September 1996	Transfer of the International Fund Pilot Fund Loan Book and contribution to the continuation of the Loan Fund	3	3
LEDU September 1996 (EU Peace and Reconciliation Programme)	To provide loans up to £20,000 per applicant	0.5	0.5
LEDU March 1997	Assistance towards the management of the Loan Fund	0.25	0.25
The International Fund November 1999	Assistance towards the establishment of a Venture Fund	0.5	0.4
LEDU October 2000	To make equity investments in Small and Medium Enterprises in NI	0.25	0.2
Totals		**4.5**	**4.35**

Source: Invest Northern Ireland Investigation

LEDU's Verification of Terms of Letters of Offer to the Loan Fund

4.7 The investigation found that the information held by the former LEDU on the EBT Loan Fund was "*insufficient for the purpose of establishing whether the prior conditions and general conditions of the Letter of Offer have been fully satisfied*". It was a condition of the March 1997 Letter of Offer that EBT would provide LEDU with confirmation of funding support from the private sector, when it became available. After the first instalment of grant had been paid to the Loan Fund, Mrs Townsley supplied LEDU with a copy of a Letter of Offer from a bank for £250,000 of commercial funding. This funding was never received by EBT Loan Fund.

4.8 The EBT Loan Fund had agreed, under the March 1997 Letter of Offer, to develop and agree operational systems with the former LEDU, with particular reference to aftercare for EBT clients. There is no evidence in LEDU records that these systems were developed.

LEDU did not Effectively Challenge EBT when it Exceeded the Maximum Loan Value Permitted

4.9 The former LEDU's Letter of Offer of September 1996 to the Loan Fund set a maximum loan of £20,000 per applicant. The investigation found that five loans greater than £20,000 were subsequently made without LEDU's approval.

4.10 The EBT Venture Fund Letter of Offer from the former LEDU also set a maximum level of grant funding for each application – in this case £50,000. The investigation found that 50 per cent of investments made by the Venture Fund had exceeded this limit, including two investments of over £100,000. A further two of the five investments under negotiation during the investigation were valued at £100,000. LEDU had not authorised an increase in the maximum investment size.

4.11 A LEDU/Invest Northern Ireland Grant Inspector identified and queried an EBT Venture Fund investment of £70,000 in September 2002. The investigation found that Mrs Townsley wrote to the Inspector explaining that the investment was made in two parts, each under £50,000 and that non-LEDU monies (i.e. the International Fund) were used for the balance above £50,000. However, the investigators were not convinced by this argument. They found that all funds provided to the EBT Venture Fund were pooled in one bank account and were not accounted for separately in the books and records of EBT Venture Fund.

4.12 The investigation also found that in her response to the Grant Inspector, Mrs Townsley claimed the Inspector was asking the EBT Venture Fund to compile inappropriate data as well as "*… diverting our effort [EBT Venture Fund] from our main concern which is managing the fund and achieving investment*."

LEDU's Evaluation of the Performance of EBT

4.13 In 1999, the former LEDU commissioned an evaluation of all its Seed Capital Funds[24]. The independent consultants reported in October 1999, citing the EBT Loan Fund as an example of good practice. However, the report contained a number of errors. It included the activities of the Pilot Loan Fund in describing the number and value of EBT loans. It stated that the value of the fund was £5 million, while only £3.5 million of capital had been raised. The investigation found this report also significantly understated the level of bad debts. These were reported to be at a one per cent level, but Invest Northern Ireland found the level of bad debts written-off to be at least six per cent.

24 Seed Capital Funds make finance available to new and pre-start businesses which otherwise may not be able to access funds.

Compliance with Statutory Regulations and Other Authorities

4.14 The investigation found that the Venture Fund and MTF may not have complied with the requirements of the Financial Services Authority (FSA), by engaging in activities regulated under the Financial Services and Markets Act 2000, which came into effect on 1 December 2001. The investigation found MTF and the Venture Fund may have required direct authorisation from the FSA. However, neither MTF nor EBT Venture Fund had FSA authorisation.

4.15 MTF has told the investigation and the EBT Venture Fund Board that it considers its activities do not require FSA regulation. MTF added that it complies with the requirements of its professional body (the Institute of Chartered Accountants in Ireland) in regard to its investment activities and that neither of the Letters of Offer providing funding for the Venture Fund required any specific regulatory framework. Mrs Townsley told NIAO that: "*MTF are externally audited to ensure they operated appropriately. MTF did not require direct authorisation for their activities under their contractual obligation to EBT*". Mrs Townsley added: "*MTF had an annual review of its activities to ensure that it was within its appropriate regulatory framework. This was confirmed each year*".

4.16 The Department told us that Invest Northern Ireland has had discussions and has been in correspondence with FSA regarding whether there was a need for direct authorisation in this case. Invest Northern Ireland has provided background information to FSA regarding the activities of EBT Venture Fund and its managers. Invest Northern Ireland has also recently met with FSA to discuss the relevant issues. FSA has not indicated what action, if any, might be taken in this matter but they have said that in reaching any decision, they will take into account the fact that the EBT Venture Fund ceased making new investments over two years ago and the company is now in liquidation.

4.17 NIAO asked the Department whether it gave the former LEDU approval to assist the establishment of loan and venture capital funds such as EBT and whether DFP approval was required and, if so, when it was given. The Department told us that it had provided LEDU with a delegated limit of up to £500,000 over a rolling five year period for financial assistance for development purposes. The Department also told us that, at this time, LEDU had a delegated limit of £150,000 over three years for operating grant, subject to an annual maximum of £100,000 – expenditure above this level required Departmental approval. The Department also had a delegated limit of up to £250,000 for operating grants subject to an annual maximum of £100,000. Grants over this limit had to be approved by DFP. The Department told us:

- it approved the operating grant to EBT of £250,000 in 1997. However, DFP approval should have been sought as the annual maximum of £100,000 would be exceeded; no explanation could be offered for the oversight – it appears that the point was not picked up; and
- it does not have a record of approving the £250,000 funding, offered in the October 2000 Letter of Offer to the Venture Fund.

The Role of the LEDU Executive on the EBT Board

4.18 A senior LEDU official (Director of Corporate Services) was appointed to the EBT Board at its inception and continued until he withdrew, on the advice of Invest Northern Ireland's senior management, in November 2002, finally resigning from EBT in November 2003. This official was independent of the decision to establish and award grant aid to the Loan Fund and was not involved in LEDU's assessment or the decision-making process in relation to the EBT Venture Fund proposal. However, he told the investigation that as LEDU provided funding to EBT Venture Fund through the EBT Loan Fund, there was a lack of overall clarity as to his position on the Board of EBT Venture Fund. He stated: "*I did not attend Loan Committee Meetings in the early years but some time after the setting up of the Venture Fund, I decided to* *attend in order to obtain a better understanding of the Venture Fund. The Committees were generally made up of one nominated Director and two others on a rotating basis. When I attended I did not vote on proposals*".

4.19 Clarity over the role of Government nominee directors is an issue which PAC has dealt with in the past. More than twenty years ago, in its report following the collapse of the DeLorean car project in Northern Ireland, PAC highlighted that one of the key lessons from that experience was that: "*It is essential that the role of nominee directors should be clarified, so that all concerned with future projects… are aware of the directors' duties, responsibilities and requirements*."[25] This was a landmark report on industrial development practice in Northern Ireland and an unequivocal assurance was given by Government that extensive guidelines had been put in place on the role of nominee directors which must be observed[26]. The importance that PAC attached to this point was further underlined by the Committee's follow up report on "The Role and Responsibilities of Nominee Directors"[27]. The Committee considered it "*…essential that the role of nominee directors should be clarified so that all concerned with future projects attracting public financial assistance were aware of the duties and responsibilities of such directors; and that only persons of the necessary calibre should be so appointed*".

4.20 In February 2005, DFP clarified its guidance with regard to the role of departmental representatives on the boards of sponsored bodies. The guidance recognises that involvement on boards can be useful and enhance working relationships. But it also creates the potential for conflicts of interest, blurring of the decision-making process and the potential for embarrassment for departments. The guidance states that board membership in limited companies provides particular difficulties, as the director has a fiduciary duty to act in a corporate manner for the benefit of the company. It recommends that such a situation should generally be avoided because the responsibilities of being a director could create a potential conflict with the official's departmental role.

25 Twenty-Fifth Report from the Committee of Public Accounts (Session 1983-84), Financial Assistance to DeLorean Motor Cars Limited. 127-I paragraph 98.

26 Committee of Public Accounts (Session 1984-85) Memorandum from the Department of Finance and Personnel, February 1985 page 16, paragraph (8).

27 First Report from the Committee of Public Accounts (Session 1985-86), Role and Responsibilities of Nominee Directors. 33 (incorporating HC (1984-85) 124-i).

NIAO Comment

4.21 It is clear that the monitoring regime exercised by the former LEDU in this case was extraordinarily lax. The evidence provided by the investigation shows that:

- LEDU failed to adequately monitor its payments to EBT and the performance of the Funds. LEDU did not ensure that EBT abided by the terms under which it had provided funding;
- LEDU made payments to EBT in advance of need, contrary to Government Accounting rules. LEDU should have ensured that it was not possible for EBT to build up a large cash balance while continuing to draw down further assistance; and
- LEDU also failed to establish whether EBT was in compliance with the Financial Services Authority.

4.22 It is a matter of concern that DFP approval was not obtained for two grants to EBT, one of which also required Departmental approval.

4.23 The former LEDU appears to have accepted information provided by EBT at face value without exercising the required challenge function. On the one occasion when a relatively junior member of staff did challenge the information provided by EBT, when the Grant Inspector questioned EBT's funding of loans over the maximum sum permitted, it appears that his concerns were dismissed by Mrs Townsley. In NIAO's view, it was fundamentally unsound for junior staff to be expected to exercise an effective challenge function in relation to matters in which one of their Board members was playing a prominent role and where she was dealing directly with their queries.

4.24 PAC has been particularly emphatic on the need for clarity in the role of Government nominee directors. Where the Committee has drawn out important lessons from past project failures in Northern Ireland it is essential that the Department ensures that these continue to be applied. The LEDU nominee directorship had the potential to contribute to more effective handling of the many problems identified in this report.

4.25 The vouching of payments and monitoring of projects such as EBT is vital for safeguarding public funds and ensuring that money is spent in accordance with Parliament's intentions. Effective monitoring capacity should, therefore, be part of the core competency of a body such as the former LEDU, which was distributing large sums in selective financial assistance to private enterprises. Equally, it is central to the Department's oversight responsibilities that it should have satisfied itself that LEDU was monitoring projects competently. In NIAO's view the absence of an effective monitoring regime over the life of this project contributes to the impression that has emerged throughout this report of a profound failure of governance in LEDU.

Appendices

Appendix 1
(paragraph 8)

Chronology of EBT Loan and Venture Funds

Date	Event
July 1993	Mrs Townsley appointed to LEDU Board (Deputy Chair from December 1995).
March 1994	The International Fund Pilot Loan Scheme established, with MTF as one of two joint managing agents.
March 1996	LEDU and MTF among four organisations invited to tender for establishment of a body to succeed the Pilot Loan Fund.
April 1996	The International Fund Board met to consider tenders. MTF proposal was considered the best, with the LEDU proposal a poor second. The Board, however, considered that the MTF proposal lacked the solidity of a major public sector sponsor. The International Fund Board instructed its consultants to negotiate with MTF and LEDU with a view to producing a joint and agreed proposal. In the event, a joint and agreed proposal was never prepared; rather the MTF proposal was updated and submitted to both the International Fund and LEDU in May 1996.
September 1996	LEDU funding of EBT Loan Fund approved by then LEDU Chief Executive.
24 September 1996	The International Fund issued a Letter of Offer of £3 million to EBT Loan Fund. A management agreement, with MTF and FPM, was a prior condition of the offer.
25 September 1996	EBT Loan Fund incorporated.
27 September 1996	LEDU issued a Letter of Offer providing £500,000 to EBT Loan Fund.
30 September 1996	Pilot Loan Fund portfolio transferred to EBT Loan Fund.
March 1997	LEDU issued a Letter of Offer providing a further £250,000 to EBT Loan Fund.
25 June 1999	The International Fund Board approved the setting-up of EBT Venture Fund.
October 1999	'Evaluation of Seed Capital Funds' prepared on behalf of LEDU, included EBT Loan Fund as an example of best practice.
16 November 1999	The International Fund issued a Letter of Offer to EBT Venture Fund for £500,000 (£400,000 was paid).
February 2000	LEDU commissioned an independent appraisal of Venture Fund proposal.
29 June 2000	EBT Venture Fund incorporated.
30 June 2000	LEDU Finance Committee approved funding of EBT Venture Fund.
October 2000	LEDU issued a Letter of Offer of £250,000 to EBT Venture Fund.
February 2001	Consultants engaged by EBT Loan Fund to evaluate its performance.
April 2002	LEDU is replaced by new body – Invest Northern Ireland.
10 September 2002	LEDU/Invest Northern Ireland Grant Inspector visited EBT Venture Fund.
30 September 2002	Venture Fund allocated share capital to EBT Venture Fund Board Members, EBT Loan Fund and MTF.
November 2002	LEDU/Invest Northern Ireland's representative ceased attending EBT Board Meetings, on advice from Invest Northern Ireland's senior mangement.
January 2003	Invest Northern Ireland engaged consultants to carry out an investigation into EBT.
November 2003	LEDU/Invest Northern Ireland representative resigned from the EBT Boards.
April 2005	EBT appointed liquidators.

Scource: NIAO

Appendix 2
(paragraph 10)

Mr Kieran Donnelly
Assistant Auditor General
Northern Ireland Audit Office
106 University Street
BELFAST
BT71EU

5 January 2006

Dear Mr Donnelly

Governance Issues Arising in the Department of Enterprise Trade and Investment's Local Enterprise Development Unit (Ledu).

Thank you for the opportunity to see the draft report, on the above and to comment.

I am of the firm view that the Audit Office performs a very important function including its role in ensuring that public funds are spent in an appropriate way and that there is value for money. I do believe that some of the information provided to the Audit Office in this case has been misleading and in many instances incorrect.

Your office is, of course, already aware that I did not ever receive a copy of the full PWC report only the extracts which I was informed by INI's Lawyers were relevant to the role of MTF.

You are also aware of, and I understand have been supplied with, my detailed and documented response to the extracts of the PWC report. My response identified numerous inaccuracies, misstatements and inappropriate implications and flawed conclusions, and amounted to a comprehensive rebuttal of the PWC extracts. The amendments made by PWC did not, to any significant extent, reflect proper consideration of the detailed, and evidenced, responses made in my document.

I note that the NIAO draft report claims to have drawn heavily on the PWC investigation report and seems to have accepted the PWC report as being accurate and balanced yet the draft NIAO report does not refer to, or acknowledge my response document which directly challenged, refuted, and rebutted the PWC extracts.

I understand that a copy of the draft PWC report was provided by INI to DETI in February 2005 for comment by DETI. I do not know what comments DETI provided but I do note that although INI had, by then, been in receipt of my detailed response and supporting documentation since October 2004 it decided that documentation was not to be sent to DETI for it to consider with the draft PWC report.

In addition to the inadequate response of INI to my document a similar absence of response was experienced by the EBT Board to its comments on 23 issues of "concern" raised by INI/PWC at an earlier stage in the investigation process.

I am also unclear regarding how PWC were appointed to conduct this lengthy investigation at very considerable public expense. I was informed by INI's Chief Executive at the commencement of the investigation that it was INI who were appointing PWC to investigate but subsequently it appeared that PWC's appointment, on behalf of INI, was by Solicitors acting for INI.

I have set out below detailed comment on specific paragraph and section of your report however I would like to draw your attention to a number of key facts.

Ledu Board Membership

I did not seek out the position as a Board Member of Ledu in 1993. I received an approach from the Department at a Senior level and was asked if I would take this position. I believe this was in recognition of my skills and experience particularly with small business. I served two terms and was then asked to take a third term the reason given was that my particular experience and skills set could not be replaced. This decision was approved by the Minister at the time. On an annual basis I made a declaration of my interests and also those of close family members. Due to the structure of Ledu my other interests, which were formal Directorships were also declared in the Ledu's annual return which was filed at the Registry of Companies. When I applied for the position of Board member of Invest NI, I was interviewed and selected. Again my other interests and those of my family were declared at the time and annually thereafter.

As a Board member of Ledu, subsequently Vice Chair, I was in no different position to any other Board member or the two individuals who Chaired the Board in my time. We were non executive Directors who relied on the executive Directors of the Board, the presence of a senior representative of the Department, the rigorous system of internal audit carried out by the Departments Internal Audit Service as well as the external Audit carried out by a respected international firm of Chartered Accountants.

Establishment of EBT

There is I believe a fundamental error at the outset of this report upon which many comments are prefaced. Ledu did not establish Emerging Business Trust (EBT). The International Fund for Ireland (IFI) established EBT through a tendered bid. This bid also included the tender to administratively manage EBT and it was won by my firm as part of a consortium. Ledu were invited by IFI to participate in the funding of EBT by way of grant under a structured letter of offer. IFI also selected the EBT Board in consultation with Ledu who were invited to offer names for membership. My appointment was by IFI. The establishment of EBT was overseen by an IFI Consultant and regular reports of progress were made to IFI Board as well as a senior civil servant in the Department.

I was not privy to the internal decision or approval mechanism of Ledu's support to EBT, due to my role within EBT. I trusted that the controls and safe guards within the system were being exercised. This was strengthened by the role of the Department representative on the Ledu Board and the close interest taken in EBT by the Department's senior official who was responsible for European funding (P&R funds).

I understood that the Department of Finance and Personnel was required to be involved in the process given the cumulative level of Ledu's support of EBT.

Structure of EBT

Emerging Business Trust (EBT) was a separate independent company limited by guarantee with a strong and experienced Chairman, well known Economist and Journalist John Simpson OBE and an equally experienced Board of 9 individuals drawn from international business and academia plus myself. Two of these individuals represented the funders IFI (Victor Haslett) and Ledu/ Invest NI (Dr. Alan Neville). This was a very sophisticated and high powered Board which made the decisions regarding the business of EBT and EBT Venture Fund. My role as Administrative manager of the company made me a servant of the Board. Business of the company in particular in relation to loan or investment decisions was strictly carried out, according to the Memorandum and Articles of the company in so far as I had no part in these decisions. The Chairman worked closely with me and gave of his time untiringly to ensure he was involved in all processes and decisions as did other Board members. The report does not take cognisance of this relationship central to the operational practice of EBT and EBT VF.

EBT was mainly funded by an offer of Grant from IFI of £3 million. This consisted of a loan portfolio (pilot loan portfolio) of some £1,639,043 cash which had been repaid from loans issued and additional cash totalling some £1.2 million. The total of £3 million was not all paid over to EBT by IFI and a shortfall of some £116,000 was recorded in EBT's accounts as a debtor/ amount due from IFI. The loan portfolio consisted of loans which had been issued by IFI on the decision of its Board to support the individual businesses. Given the need for this support and the ethos of IFI these loans were very high risk and little or no security was taken by IFI. No provisions for bad debts were made on the loan portfolio at the time IFI passed it over, unlike other similar transactions by IFI. In this respect EBT Board noted the losses on their balance sheet as a decrease in the capital given by IFI, not through their P&L account as they did with provisions they made on lending decisions by the EBT Board. This treatment of bad debt was considered at length by the Board and the company auditors. IFI and Ledu were aware of this through their Board representatives and through the annual accounts which were submitted to them.

Bad Debt Provision

Despite the high risk profile of the pilot loan portfolio some 67% of the loans had been repaid or recovered by the time EBT was put into liquidation. This compares favourably with the Department of Trade and Industry's Small Firms Loan Scheme which would not have as high a risk level.

Of the loans issued by EBT the provisions level was an absolute 17.5% of loans issued. This included 5% additional provisions due to the acceleration of write off provisions, as suggested by Invest NI's Consultants, which is questionable given the subsequent level of recovery. Again, if compared with lending bodies of a similar risk profile, this was not unreasonable.

EBT Board regularly reviewed the portfolio and those who were in default and the Board took the decision when this was provided for under bad debt provisions. This is formally noted in Board minutes and in case meetings as the Board also delegated the authority to 'write off/ provide for bad debts' to its case committee in 1998.

The Graham Review of the Department of Trade and Industry's (UK) Small Firms Loan Guarantee scheme reported (October 2004) bad debts in the region of 30-35% for loans issued between 1993 and 2000. Graham concluded that given the lending profile (start ups and early stage businesses) this was not unreasonable. The lending profile of EBT would be very similar.

Success of EBT

EBT Board calculated the jobs it has assisted to create through its loans and investments and the total costs of EBT after its income streams. These costs included significant costs necessitated by the Invest NI investigation. This 'cost per job' sum was some £252 per job. This compares very favourably with a figure of some £5,000 cost per job for Ledu and some £15,000 per job for IDB. The calculation for Invest NI has not to my knowledge been made public. The modest support by EBT which was often the 'cornerstone' of funding leveraged some additional £35 million of funding into these businesses.

The loan fund which was funded by the £500,000 of Peace and Reconciliation monies granted to EBT by Ledu were lent and relent some 2.4 times. The provisions on the portfolio amounted to under 16%, which is not unreasonable given the criteria of disadvantage the applicants met to have their application for loan approved.

Potential Conflict of Interest
I believe where required we declared and made appropriate information available to identify where a potential conflict of interest arose with the applicants to EBT. PWC identified a number of cases which they highlighted. A detailed response has been made by me case by case which does not appear to have been taken into account by PWC and certainly is not mentioned in the NIAO draft report. It should be noted that the cases in which PWC noted potential for conflict was identified was from information in the EBT case files which demonstrates that the information was openly available. MTF had divested its accountancy practice by December 1999 to avoid potential for conflict of interest.

EBT Board commissioned an independent consultant in 2004 to carry out a review of potential conflicts. This review covered past and potential future conflicts. In the main the consultant reported that controls and disclosures mitigated against the potential for conflicts.

Payments to MTF
With regard to the MTF work for EBT, at no time had we ever a complaint from EBT as to the quality of our work or that it was not value for money. In fact we were frequently commended by the Board. Numerous audits and reviews were carried out including an audit by the European Court of Auditors and a direct audit from the Department. At no time was there anything unusual noted and EBT was consistently commended for the success of its funding. Payment to MTF was mainly from a set schedule of work and set payments for that work. The Board discussed and approved all payments to MTF.

Throughout the eight and a half years that MTF carried out work for EBT, MTF incurred all the associated costs. EBT had no staff or premises. MTF paid for staff and all costs in relation to the delivery of this contract. The average net annual 'profit' from the contract was less than £20,000 and being a partnership my salary was paid from any profit. The contract sums were fixed in 1996 by IFI. The EBT Board agreed a modest increase for some elements of work in December 2002 and agreed to pay some out of pocket costs which were being incurred by MTF on behalf of EBT. The increase amounted to an average annual increase of 1.8%.

Dialogue
The report indicates that Invest NI instigated dialogue and discussion with EBT Board throughout the process of the investigation which started in 2003. This is shown to be incorrect by the vast amount of correspondence to INI and the Department from EBT. I do not recall one single meeting of Invest NI with the Board of EBT in this respect. When the interim findings (which were given to EBT in lists of "issues") were made, EBT responded promptly but to date no comment has been made to EBT or MTF on the responses. EBT was put into liquidation primarily because INI and IFI would not appoint a replacement Board or give any help or guidance as to their wishes for the future of EBT. This is borne out by the press releases of the EBT Board, in the EBT Chairman's correspondence to INI and to the Minister and in the statement to creditors presented for the winding up petition. The EBT Board concluded that it had become an inter agency dispute between INI and IFI for EBT's cash resources and with the lack of guidance from INI and IFI determined there was no option but to put the companies into liquidation.

As a former Board Member of Ledu, INI and of EBT and EBT VF I am saddened and frustrated at the outcome of events which had necessitated the Members voluntary liquidation of these Trust Companies. The views of my fellow Trust Board Members have been set out in detail in press releases of January and March 2005 and in the letter of 7th April 2005 from our Chairman, John Simpson, to the Minister at DETI.

It is correct that the focus should be value for money and the facts speak for themselves that during their years of operation, EBT and EBT VF delivered considerable value for money.

As indicated above the detailed comment is set out in the following tables, referenced to the draft Northern Ireland Audit Office report as received by myself and my partner on 15th December 2005.

Detailed Comment

	NIAO summary section at front pages 7 - 11
NIAO Para Ref **(Para Refs have been amended to agree with final report)**	**Comments**
2	This is incorrect. IFI established and set up EBT with MTF who had won a bid tender. LEDU funded by grant offer. This is fundamental as it distances TT (who was a Board member of LEDU at the time). Her reporting was to IFI. The Department response agrees this point. (Page 30, Part 1 paragraph 1.41, page 15 paragraph 1.3)
3	This is incorrect. IFI provided the following:- Cash funds of £1,244,957 Portfolio of loans (with no bad debt provisions made), £1,639,043 Board members were selected by IFI, in consultation with others.
4	EBT Board had no option but put both companies into liquidation in March 2005, due to the failure of Invest NI and IFI to consult as to the future.
10	There are inaccuracies. • Mrs Townsley took no part in the decision of Ledu to approve funding to EBT and will be recorded as absenting herself at any related Board decision. The Department which was responsible for Ledu had a senior individual [name omitted by NIAO] overseeing the process of set up of EBT and was aware of Mrs Townsleys position in each organisation. MTF were not paid 'fund management' fees, but paid set fees which were work related. MTF discharged all of the related costs. As a non executive Director of Ledu Mrs Townsley will have relied on the internal checks and balances within Ledu to ensure proper order as well as the role of the Department and DFP.

	• The loan fund was already established by IFI as a pilot and it was IFI who were leading the establishment of EBT. In 1997 the European Court of Auditors reviewed the funding of EBT by Ledu (including a visit to MTF and EBT and examination of its books and records) and there was no negative comment to EBT. With regard to the Ledu letters of offer it was confirmed in writing to MTF that the preconditions of funding had been, met after the appropriate proofs had been submitted. Copies of all of this information are in files held by the liquidator (EBT box 81) and were seen by PWC. • The contract for the administrative management of EBT was tendered to IFI in the tender document submitted by MTF to IFI to assist to set up EBT. • We believed we had made appropriate disclosures regarding potential conflicts of interest at the time. The Board of EBT was very aware of the businesses of MTF. • This is incorrect and has been stated without reference to the correct data and comparative to other similar funds. The correct data is set out in the opening paragraphs above. • Quarterly reports on the fund were submitted to Ledu and then to INI throughout the life of the fund (EBT box 81), an external evaluation was submitted (EBT Boxes 31, 56) and numerous audits both by Ledu and the department were carried out. All of these files were seen by PWC.
11	My Solicitor has written to NIAO concerning this and to seek correction of the wording to clarify that the investigation found no evidence of collusion in relation to Mrs Townsley, MTF, EBT and EBT VF. Any ongoing investigation does not concern these individuals or bodies but relates to the three other bodies referred to.
12 -16	As a Board member of Ledu and vice chair, Mrs Townsley was in the position of every other Board member and the chairman in that she relied on the papers and documents supplied to the Board, together with the explanations sought where they were not content with what they had been given or sought further information. Mrs Townsley also relied on the reports from a rigorous programme of internal audit (carried out by the Internal Audit Service of the Department) as well as the assurance of the external audit carried out annually (Deloitte Touche) which had unqualified audit opinion. This was added to by the presence of the Departments representative at Board meetings and the regime of reporting to the department.
17	• [fifth] This is incorrect by omission. It is important to state that Mrs Townsley was asked to stand aside from the Board of Invest NI. She asked that if there were specific reasons why she should do this they should be made known to her. None were given and she continued to attend Board meetings and other related meetings, unchallenged, at Invest NI until the end of her term of office

	• [sixth] This paragraph suggests there was dialogue and discussion with EBT Board throughout this process which started in January 2003. This is incorrect and borne out by the vast amount of correspondence to INI and the department from EBT. When the interim findings (which were given to EBT in lists of 'issues') were made EBT responded promptly but to date no comment has been made to EBT or MTF on the responses. EBT was put into liquidation primarily because INI and IFI would not appoint a replacement Board or give any help or guidance as to their wishes for the future of EBT. This is borne out by the numerous press releases of the EBT Board, in the Chairman of EBT's correspondence to INI, to the Minister (April 2005), and in the statement to creditors presented for the winding up petition (April 2005). The board concluded that it had become an inter agency dispute between INI and IFI for EBT's cash resources and with the lack of guidance from IFI and INI determined there was no option but to put the companies into liquidation.
	Part 1, pages 12 - 20
NIAO Para Ref	**Comments**
1.1	It should be noted that fees for this separate limited company in relation to Jobskills were applied as per the contract. The training income included allowances for trainees (approximately 65% of the income per trainee). In this period 6 national training awards were achieved in recognition of the success of the training. The contract was relinquished as the onerous terms of the contract were not able to be funded by the income and was being subsidised by other group companies.
1.4 1.5	This paragraph confirms that the set up of EBT was by tender. This acknowledges that IFI were responsible for the set up.
1.6	Teresa Townsley was asked, by IFI, to take the appointment to the EBT.
1.7	The chairman of EBT, Mr John Simpson, was identified before EBT was formally structured. He attended shadow board meetings until the first formal meeting on 22nd October 1996. The minutes will show that the Chairman outlined in detail the structure of EBT and the board formally approved and adopted the memorandum and articles of EBT
1.8	This appointment of MTF was won through the tender to IFI to assist to set up EBT.
1.9	The EBT board frequently asked Mrs Townsley to write up proposals after the item had been discussed at board. This was one such instance. The board would then develop the draft to its final stage. MTF's involvement was therefore at the discretion of and on behalf of EBT.
1.10	Prior to the submission of the venture fund (VF) proposal the EBT board discussed and finalised the draft 'line by line' before approval. This is minuted.
1.11-1.23	It was an EBT board decision on how the board of the VF was constructed. The comments seem to ignore the fact that EBT was an independent company governed by its strong Board. The relationship of Mrs Townsley or MTF was to the Board not to any funder.

1.20	The procedures described by Mrs Townsley were those she would have expected to operate given her involvement and the level of funding to EBT. As she had no part in the process she would have been unaware if the procedures were adhered to.
1.24	This comment is taken out of context. This view was reached by the EBT board after much discussion and is the view of the Board and should not be attributed to Mrs Townsley as an individual. Any communication of views would have been at the request of the EBT Board. The EBT board frequently provided a combination of loan and equity to companies. Their rationale was that as the Venture Fund was a subsidiary of EBT any gain on investments would benefit EBT.
1.25	As a member of the Ledu board who declared all 'other' interests regularly in writing (including those of close family members), Mrs Townsley understood in the external audit process and vetting of the accounts by the Department they would have ensured that the disclosure appropriate at the time was made. MTF were always identified as the Administrative Managers of EBT.
1.32	MTF tendered to IFI to become the administrative managers in the tender to set up EBT (1996). It was an EBT board decision not to go external to re-tender after a performance review of MTF and its staff. Mrs Townsley absented herself from these detailed discussions of the EBT Board.
1.33	It is apparent that the level of costs envisaged was higher than actually paid out. EBT was an independent private company who chose not to re-tender its administrative contract externally. MTF's relationship was directly with EBT.
1.36	Receipt of the commercial funding was prerequisite on firstly receipt of all the IFI funding which was never all received. This was highlighted to PWC.
1.39	There was a shareholders agreement drawn up and executed. (PWC saw this)
1.41	This paragraph refers to the Departments understanding that IFI set up EBT (not Ledu)
1.45	The board were appointed by IFI in consultation with Ledu and the Department.
1.46	MTF won its contract with EBT through a bid process to IFI. All payments under this contractual commitment were set and approved by the Board of EBT for work done.
1.47	The EBT Board (minuted meeting EBT on 13/12/1999) took decision on VF Board structure not Mrs Townsley- misleading and unnecessary comment. Any rebuttal of the suggested structure was that of the EBT Board.
NIAO Para Ref	**Part 2, pages 21 - 25**
	comments It should be noted that Mrs Townsley had no vote or decision making powers within EBT to make loan or investments. This is formally noted as well as enshrined in the Memorandum & Articles of EBT. MTF had fully divested itself of its accountancy client base by December 1999 to avoid potential conflict of interest. These facts have been made clear and are not reflected here.

2.5	This paragraph is misleading in the information it omits. The EBT Board was aware that EBT Venture Fund had invested in two companies in which Mr Townsley had an interest (he was a promoter of the latter Fusion). Prior to the decision to invest EBT Board were aware of the impending share issues; these became a prior condition of the EBT support. Mrs Townsley had no vote on this decision.
2.6	This is conjecture and was disproven by a very detailed analysis and a timeline provided to PWC by MTF with regard to Arcom.
2.7, 2.8	This is incorrect. A director of EBT was specifically designated to Arcom from early 2000 (Mr Slowey). A record of meetings and discussion in this respect was maintained. The minutes of 19th June 2000 were previously provided to PWC. This was prior to any investment by EBT in Arcom. EBT Board were fully aware of Mr Townsley's involvement with Arcom and shareholding when they approved and proceeded with the investment. (detailed in papers they considered and minuted)
2.9	The update report presented to the case work committee on which the decision to provide a further loan was prepared (with recommendation) by the designated director who had been liasing and meeting with Arcom, Mrs Townsley's function was administrative. This December 2002 report was based on the company's sage accounts to October 2002 which showed profits of some £30,428 and not losses as stated. The documents referred to by PWC were not available in December 2002 at the time of this decision. The risks of the sector and in particular the company at that time were considered by the EBT Board. In recognition of this and the lack of security, the EBT Board recommended the loan be made by way of the Small Firms Loan guarantee scheme, whereby EBT were guaranteed some 85% of the loan by DTI.
2.10	There was an arms length trading relationship with a subsidiary programme of the training division of MTF (separate company). This was not believed to be material to be disclosed. Both Arcom and this company declared the trading relationship in their accounts. Full details of this have previously been provided to PWC.
2.14	The structure of the shareholding was already in place for Fusion when EBT Board took the decision to invest. Mr Townsley's investment was a prior condition of the EBT investment (as set by the EBT Board). Mrs Townsley took no part in this and this is recorded.
2.16	This case came to EBT Board with the key facts written up. The committee were asked if they wished to take it further (i.e. appoint an appraiser externally). A designated director was appointed to take this forward. Later it did not proceed.

Extract Page 24	It is difficult to check the accuracy of this as we were not allowed to retain the extracts of the draft PWC report and the paragraph referred to does not match that responded to. Our response regarding the companies B, C, F and D are available if they are the same as that in the draft PWC report. We believe we answered all queries appropriately. The nature of the EBT Board case committee was that they took every effort to familiarise themselves with each case and the details therein as well as looking over the case files. These case files were set on the table at the following Board meeting for any Board member who had not been on the case committee to look at the papers and raise any query or question they had. MTF and the other appraisers were encouraged by the EBT Board to assist applicants where they needed assistance.
2.20	The papers and minutes of EBT case meetings and Board discussions reflect the disclosure of potential conflicts.
2.21	MTF were not 'fund managers' to EBT or its venture fund, this reference is incorrect.
general	The Audit Office refers to MTF as the 'fund manager' in their summary. We were not 'fund managers' as this is a specific term and definition. We had the role of administrative manager to the company and at no time were in the role of 'fund manager'.
	Part 3, pages 26 - 30
NIAO Para Ref	**Comments**
3.1 [Removed]	This is incorrect.
3.1	IFI did not pay EBT the full £3 million.
3.2	This is incorrect. The bad debt provisions for the EBT loans as calculated per proper standards is provisions as a percentage of loans issued which totalled some 17.5% cumulative which represents 2% per annum approximately.
3.2, 3.3	EBT inherited the pilot loan fund from IFI. IFI had made the lending decisions and the decision to allow only 'soft' security taken, if at all. This made recovery of defaulters difficult. EBT accounted for the write offs of the pilot loan as a reduction in the capital from IFI and fully detailed in its accounts (which were supplied annually to IFI, Ledu, and INI). Several similar loan funds account this way. All provisions were reported annually in the EBT accounts.
3.4	EBT was set up in a period when loans were not available to this type of lending base. EBT were successful in shifting that market perception thus bringing more lenders into this market.

3.5	All fees were Board approved and based on elements of work achieved. MTF carried all of the normal costs of management of a company including staff costs, rent and rates, heat and light etc., and ultimately the redundancy costs of these staff when EBT went into liquidation. EBT always had substantial funds available for lending due to the revolving nature of the loans and interest earned from loans and bank deposits. This cash sum did not go below £1 million. Thus the conclusion of the investigation in this paragraph is incorrect.
3.6	It was the failure of IFI to pay over the full £3m which prevented EBT from calling down its private sector funding as this was contingent on receipt of all of the IFI funds. (PWC were made aware of this and would have seen the relevant files at EBT/ MTF).
3.7	This cost of £1.9 M represents some 8.5 years of activity or an average of £223k per annum. These costs contributed to the income to EBT and the cost should be measured in the net deficit and number of businesses supported and jobs created which was substantial. This is summarised accurately in the opening paragraphs above. The main element of 'Aftercare', aside from monitoring and financial review, was (at Ledu's request in writing and in the Departments view) provided by the referral of EBT applicants to Ledu's suite of programmes on an individual needs basis. This was strictly carried out, the statistical data being maintained in EBT's database.
3.8 - 3.11	All fees to MTF were agreed in advance by the Board of EBT based on specific elements of work requested and measured by the work done. MTF carried all of the related costs including staff (subsequently staff redundancy), premises and related day to day costs. (Averaged at £164k per annum). The EBT Board engaged a public relations firm to increase the external profile of EBT not to replace the work MTF was contracted to do in this area. This was a Board decision
3.9	To put this in context the EBT Board approved Directors fees of some 14% of the total grant income over the same period of time that the management fees were paid. However both of these sums are not the basis of how a venture fund should be measured as the costs in the early stage are always higher in percentage terms. The true measure is the cost over the lifetime of the fund when returns and net capital gains have been achieved. This is comparable to any other similar fund.
3.15	This is incorrect. By 28th March 2003, 10 investments had been completed and another 11 were in negotiation (total 21). At this date the EBT client base were informed of the investigation by INI and understandably a number then declined to complete the investment. (This was detailed in the April 2003 Board papers as seen by PWC.)
3.16	The performance of MTF with regard to its work for EBT was continually monitored by EBT. There was never any comment with regard to dissatisfaction in fact the Board minutes record frequently the Boards satisfaction with the work. The agreement of provisions for bad debts was at the discretion of the EBT Board and not the administrative managers of EBT.

3.17	This was the decision of the EBT Board based on the merits of individual cases. This is carefully recorded in case and Board minutes
3.18, 3.19, 3.20	This is incorrect; the EBT Board did have a formal policy for the recognition, provision for and write off of bad debts. This was specifically enshrined in the procedures set for the Administrative Manager. This was evident from the regular reports and papers presented at the EBT Board. The timing of the removal of bad debts from the debtor's ledger was at the discretion of the Board. The savings indicated of £64,000 and £13,000 are not correct as even when provisions were made work continued to achieve settlement or payback of a loan in default. A full discussion took place at the EBT Board in June and September 2003 to this effect. EBT Board were conscious that they and the administrative managers should pursue debtors to 'the end'. This was also subject to annual audit and on an individual basis the advice of independent solicitors
3.21	MTF complied with all aspects of its contract with EBT. The Board files will reflect copious reports (hard copy) as well as solicited verbal reports asked for at the meeting. At every EBT Board meeting, the EBT accounts were available including the loan ledgers
3.22	This paragraph contains incorrect information. The loan fund existed for 5.5 years before the Directors put it into liquidation. At that time it had significant cash and loan assets. There appears to have been no comparative of performance to conclude that the performance of the loan fund was poor. DTI's Small Firms loan scheme reported bad debts (for a similar profile loan scheme toEBT) in the range 30-35% (HM Treasury - Graham Review October 2004).The Pilot loans met IFI expectation given the lack of security they put in place and the disadvantaged areas and people to whom the loans were made (at IFI's discretion and decision). With regard to the losses of EBT the percentage from inception was some 17.5% which included the change to policy prompted by PWC (added 5%). Some £22,000 of the provisions suggested in this way was recovered in the 6 months before EBT went into liquidation which suggested that it was over provisioned. Comparison to the DTI small firm's loan scheme suggests this was not unreasonable. The loan fund attracted commercial funding but it could not be drawn down due to the nonpayment of the balance of the IFI letter of offer. The loan debtors ledger was consistent with the accounts and was audited annually to this effect. The comment on the fees to MTF not representing value for money is not well founded and is based on incorrect information.
3.23	IFI and Ledu/ INI were aware of this before it occurred and despite being consulted did not provide any negative comment.
3.25	This is incorrect as there was an approved policy and procedures for dealing with bad debt. This paragraph does acknowledge that EBT by its very nature was involved in some high risk lending.

	Part 4, pages 31 - 35
NIAO Para Ref	**Comments**
4.1	The amount paid by IFI is incorrect. They failed to pay over the balance of some £116,000 of the £3M offer. It was this failure which prevented EBT from calling down its private sector funding as this was contingent on receipt of all of the IFI funds. (PWC were made aware of this and would have seen the relevant files at EBT/ MTF).
4.2, 4.3, 4.6	Quarterly reports on the P&R loans were provided to Ledu throughout the life of EBT. Regular accounts were provided. The evaluation of performance (carried out externally) was also provided (as stipulated in the Ledu letter of Offer). There was audit from the European Court of Auditors, directly from the department and by Ledu. (PWC were made aware of this and would have seen the relevant files at EBT/MTF).
4.7	IFI failed to pay over the balance of some £116,000 of the £3M offer. It was this failure which prevented EBT from calling down its private sector funding as this was contingent on receipt of all of the IFI funds. (PWC were made aware of this and would have seen the relevant files at EBT/ MTF).
4.8	A detailed system and operational manual was developed for the operations of EBT. This was submitted to Ledu. (PWC were made aware of this and would have seen the relevant files at EBT/ MTF). MTF/ EBT were asked (in writing) to refer applicants to Ledu programmes for after care. This was adhered to.
4.9	IFI had not restricted the loan limit. The larger loans could be paid from this fund. All loans had a unique code to identity which funds they were paid from. Ledu approval was not required in this case. There were 3 loans (at £25,000 each) not 5, as stated. The other two loans appeared to be £500 over due to the addition of EBT's opening administrative charge being applied to the account. (PWC were made aware of this and would have seen the relevant files at EBT/ MTF)
4.10	Again IFI did not restrict the investment level from their funds. Investments could be identified to the funds from where they came (see 4.9). (PWC were made aware of this and would have seen the relevant files at EBT/ MTF).
4.11	See 4.9 and 4.10 above. While funds were pooled to achieve maximum bank interest, the coding system did allow trace back to the source funds in all cases. It is factually incorrect to say that "it would not have been possible for the venture fund to identify elements of individual investments as coming from one or other of its funding bodies".
4.12	This is taken out of context of a fuller letter and is misleading. The Board of EBT were made aware of the visit of the Inspector and his correspondence in this regard. After discussion the stated view was reached by the EBT Board. Any communication of views or comments would have been at the request of the EBT Board and was the view of the Board and should not be attributed to Mrs. Townsley as an individual.
4.13	The database of loans issued by EBT, together with the bad debt provisions show that at the end of 1999 the cumulative level of provision for the three years was 4.48%.

4.14	MTF are externally audited annually to ensure they operated appropriately. MTF did not require direct authorisation for their activities under their contractual obligation to EBT.
4.15	MTF had an annual review of its activities to ensure that it was within its appropriate regulatory framework. This was confirmed each year.
4.23	This is incorrect all information requested in this audit was provided and access was given to all the books and records of EBT.
4.25	MTF/ EBT provided significant reports and monitoring information to Ledu and then to INI directly as well as through the Board papers to the nominee director (Mr Neville).
NIAO Timeline Appendix 1	Reference April 1996, this is incorrect; MTF won the bid to assist to set up EBT. There was no joint proposal with Ledu. MTF were asked by IFI to establish EBT and to ask Ledu to participate in the financing. This has been clarified in notes of meetings with IFI and correspondence with Ledu which was all provided to PWC.
	Appendix 6
NIAO Para Ref	**Comments**
1	The venture fund worked in shadow form while the advisors devised the most appropriate framework. MTF's work in this respect preceded the formal set up. The Board of EBT approved this payment. The Board of the venture fund were also paid for this shadow period. This is not unlike Invest NI which operated a 'shadow board' from August 2001 until its formal setup on 1st April 2002. All its Board members and advisors were paid for this period.
2	EBT Board agreed to reimburse MTF for certain 'out of pocket' expenses as well as for work which was not remunerated under the existing agreement. A sum of £750 per year from 2003 was approved (by EBT Board in December 2002) for a minimum of 3 days work to prepare analysis etc., for the EBT Auditors. The sum reimbursed for postage was in the region of £250 (2003-5) and included the cost of Courier for one Directors papers to Dublin on a regular basis. Detailed analysis of this was provided. All payments to MTF were EBT Board approved.
3	The arrangement for the administrative management of 5% was from the period that the investment was made onward. The other costs and fees approved by the EBT Board were outside of this remit All payments to MTF were EBT Board approved.
4	The Full EBT Board including the representatives from IFI and Ledu/ INI amended and finalised the initial business plan for the Venture Fund once they finalised its structure. This included the projections of income and costs. The Approved Directors fees were not included in the initial draft plan submitted, but were included in the final plan along with the management fees. These projections were submitted to Ledu at the time. The EBT Board discussed and approved any and all payments.

In conclusion I ask that in the interests of fairness and equality that my comments and full response are made available to all those who will have access to the NIAO report.

Yours sincerely

Teresa Townsley

Appendix 3
(paragraph 15)

Concerns over Standards of Financial Management in the period 1995 to 2002 in LEDU and Other Bodies Sponsored by the Department of Enterprise, Trade and Investment.

1. Issues arising from the investigation into EBT should be seen in the context of a number of instances of weak corporate governance practice in the former LEDU and other bodies sponsored by the Department. Over the past decade, concerns have been raised in a range of reports from the Westminster Committee of Public Accounts, the Northern Ireland Assembly Committee of Public Accounts and the Northern Ireland Audit Office.

LEDU Frauds

2. Between 1996 and 2000 there were a series of internal frauds against the former LEDU. The total amount of actual and attempted fraud was almost £220,000. The frauds were made possible by a number of basic weaknesses in financial controls including inadequate separation of duties, inadequate control of purchase orders and poor supervision.

3. The Assembly PAC, in its Eleventh Report of Session 2001-2002 (Report: 11/01/R) into the LEDU internal fraud stated that: "*It is quite clear to us that we are dealing with a failure to adhere to the most elementary principles of financial control. There appears to be a culture of weak financial management and it is astonishing to find that a Government agency, whose remit included advising small firms on financial control systems, was incapable of keeping its own house in order. In the light of this case, it is essential that new public bodies such as Invest Northern Ireland (which now has responsibility for functions previously carried out by LEDU), establish robust financial controls at the outset*."

Previous Concerns about LEDU's Management and Oversight of Loan Fund Activity

4. In 1998, the C&AG reported on deficiencies in the control exercised by LEDU over a voluntary body, known as Ortus, which had received over £1 million of assistance from the former LEDU to set up a loan fund. The parent Department was unable to confirm that the funds had been applied for the purposes intended by Parliament and, as a result, the C&AG qualified his audit opinion on the then Department of Economic Development Vote 2 Appropriation Account[28]. The problems included:

   - poor control systems, including a lack of evidence of monitoring of loan payments and non-payments and poor debt recovery procedures;
   - incomplete records and poor audit trails; and
   - a lack of adequate documentation of loan arrangements, including an absence of signed loan agreements and insufficient documentation supporting key decisions on repayment re-scheduling, moratoria and write-offs.

28 Northern Ireland Appropriation Accounts 1997 - 1998. Department of Economic Development, Vote 2 : Other Economic Support Measures, Administration, Energy and Miscellaneous Services.

Qualification of 2002-2003 and 2003-2004 Invest Northern Ireland Accounts in respect of deficiencies inherited from LEDU

5. The C&AG qualified his opinion on the 2002-2003 and 2003-2004 accounts of Invest Northern Ireland because there was insufficient evidence on the recording, monitoring and use of the £10 million in total received by TPOs in those two years. Payments made by the former LEDU before 2002-2003 had not been supported by an adequate system of controls. These deficiencies were inherited by Invest Northern Ireland. In 2002, as a result of the concerns arising from an investigation into a TPO known as 'Into the West' (see paragraph 7 below), Invest Northern Ireland commissioned consultants to conduct a review of TPO contracts inherited from LEDU. The consultants found that the contractual and purchasing arrangements with TPOs were deficient.

6. In response to these findings, Invest Northern Ireland introduced revised procedures over new contracts in 2003-2004. New guidance has since been issued and a specific audit and control function set up to manage the budgets of TPOs. In addition, as recommended by the C&AG, Invest Northern Ireland introduced a risk based inspection programme of the books and records of TPOs. As a result the qualification of Invest Northern Ireland's accounts was removed for 2004-2005.

7. In July 2004, the C&AG reported on Into the West (Tyrone and Fermanagh) Limited, a TPO set up and funded through an initiative led by the former LEDU working in partnership with five District Councils. Into the West received public funds of £386,000, including £189,000 from LEDU, between 1997 and 2002. In December 2001 allegations of financial impropriety and poor value for money were made against the company. A subsequent investigation showed that:

   - there had been very poor standards of administration involving considerable sums of public money. Among the most serious findings were concerns that, out of a total of £155,000 expenditure examined in the investigation, £40,000 was unsupported by receipts and invoices and cash withdrawals remained to be properly accounted for;
   - there was a lack of control and evidence of extravagance in relation to corporate hospitality and overseas visits; and
   - the report questioned the adequacy of the supervision and control arrangements exercised by LEDU.

PAC Concerns in Relation to Conflicts of Interest

8. The handling of conflicts of interest has arisen as a major issue in relation to the Department's bodies:

   - in 1996, the Committee[29] concluded that: "*When a body is disbursing substantial funds it is essential that it ensures, as far as possible, that conflicts of interest do not arise but, where they do, there are stringent procedures to avoid any suspicions of impropriety. We endorse the C&AG's view that it can never be acceptable for a Board Member to negotiate directly with Board officials for grant assistance.*"

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29 Committee of Public Accounts, Eleventh Report of Session 1995-96 on Selective Financial Assistance for Tourism in Northern Ireland. HC 57-i, 266.

- the Assembly PAC[30] examined the award of a substantial print contract by the Northern Ireland Tourist Board to a company connected to the Board's Chairman. The Committee's Report concluded that: "*In our view, the Board completely failed in its duty to adhere to the core public service values of fairness, objectivity and propriety in its award of substantial print contracts to…*". In a close parallel with the former LEDU's handling of EBT, the Tourist Board failed to apply proper tendering procedures in an area directly related to a Board Member's interests. PAC also concluded that: "*in our view, one of the key lessons from the Tourist Board case is that it is highly undesirable to make an appointment to the Board of a public body... in circumstances where the prospective appointee's company is carrying out substantial business worth over £1.4 million with the public body. The only effective way of dealing with conflicts of interest of this magnitude is to prevent them from happening in the first place. The solution is as simple as that.*"

30 Committee of Public Accounts, First Report of Session 2002/2003. Report on the Northern Ireland Tourist Board. Report 01/02R.

Appendix 4
(paragraph 1.13)

Guidance Issued by the Office of the Commissioner for Public Appointments for Northern Ireland

The guidance, issued August 2005, states that public appointments require the highest standards of propriety, involving impartiality, integrity and objectivity, in relation to the stewardship of public funds and the oversight and management of all related activities. This means that any private, voluntary, charitable or political interest which might be material and relevant to the work of the body concerned should be declared.

There is always the possibility for real or perceived conflicts of interest to arise. It is important, therefore, that prospective candidates are asked to identify any potential conflicts of interest, whether real or perceived, at the beginning of the process. This should be included as a question in the application form.

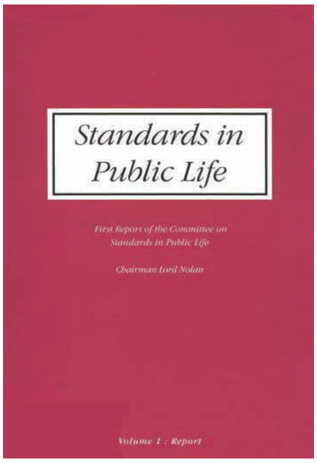
The following General Principles should be adhered to when handling the issue of conflicts of interest:

- recognition and declaration at the earliest possible opportunity;
- openness and transparency in discussing the conflict;
- individual accountability and a clear report chain; and
- appropriate procedures for segregation of individual involvement on projects.

However, the Panel will be required to explore with the candidate the potential consequences of the conflict and assess whether or not it is serious enough to warrant withdrawing them from the competition.

If the Panel believes that the conflict is manageable and the candidate is found suitable for appointment, their name should go forward, but it is then for the Department and the NDPB concerned to agree with the candidate any measures which will need to be taken to handle this conflict, in the event of them being appointed.

Appendix 5
(paragraph 1.14)



Nolan's Seven Principles of Public Life

Selflessness

Holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other benefits for themselves, their family or their friends.

Integrity

Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might seek to influence them in the performance of their official duties.

Objectivity

In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.

Accountability

Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.

Openness

Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.

Honesty

Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.

Leadership

Holders of public office should promote and support these principles by leadership and example.

Source: First Report of the Committee on Standards in Public Life, May 1995

Appendix 6
(paragraph 3.12)

Additional Payments to MTF from the Funds

The investigation raised concerns about a number of payments the Funds made to MTF in addition to the agreed management fees. The concerns were:

1. MTF charged EBT Venture Fund a full year's management fee of £10,000 for the year ending 30 September 2000. The company had been in operation from July 2000, only three months. MTF told the investigation that work was undertaken by MTF in advance of the Venture Fund being incorporated. Mrs Townsley told us that: "*the Venture Fund worked in shadow form while the advisors devised the most appropriate framework. MTF's work in this respect preceded the formal set up. The Board of EBT approved this payment. The Board of the Venture Fund were also paid for this shadow period. This is not unlike Invest NI which operated a 'shadow board' from August 2001 until its formal set up on 1 April 2002. All its Board members and advisors were paid for this period*".

2. Under the unsigned management agreement attached to the International Fund Letter of Offer of September 1996 to the EBT Loan Fund, MTF received £500 a month for management, accounting and corporate administration of the Fund. This included general administration, Board meeting facilities, director liaison and management accounting. From June 2000, the EBT Loan Fund Board agreed a number of payments to MTF for work which had previously been covered by the fixed rate management fee. The total value of these additional payments at September 2003 was £3,889 for postage and assistance with the year-end audit. Mrs Townsley told NIAO that: "*EBT Board agreed to reimburse MTF for certain 'out of pocket' expenses as well as for work which was not remunerated under the existing agreement. A sum of £750 per year from 2003 was approved (by EBT Board in December 2002) for a minimum of 3 days work to prepare analysis etc., for the EBT Auditors. The sum reimbursed for postage was in the region of £250 (2003-5) and included the cost of courier for one Director's papers to Dublin on a regular basis. Detailed analysis of this was provided. All payments to MTF were EBT Board approved*".

3. MTF submitted a paper to the Board of EBT Venture Fund in December 2002 which stated that the five per cent management fee covered "*all costs of managing the investment and the reporting structure*". The investigation found that the Venture Fund Board had agreed to introduce a monthly £300 payment to MTF for bookkeeping and accounting for the Venture Fund in September 2001 (back-dated to October 2000). The additional cost of this service was £10,800 for the three years to September 2003. In July 2002, MTF also introduced a number of fees relating to handling investments over and above the agreed fees for conducting appraisals. The total paid by the Venture Fund to September 2003 in additional investment charges is £24,950. Mrs Townsley commented that: "*the arrangement for the administrative management of 5 per cent was from the period that the investment was made onward. The other costs and fees approved by the EBT Board were outside of this remit. All payments to MTF were EBT Board approved*".

4. None of the additional fees paid to MTF by the Venture Fund had been included in the proposal for establishing the Venture Fund or in the consultant's report for LEDU appraising the proposal or in the five-year projected accounts included in the submission to LEDU's Finance Committee. The additional payments were discussed and agreed by the Venture Fund Board. Mrs Townsley told NIAO that: "*the full EBT Board including the representatives from the International Fund and LEDU/Invest NI amended and finalised the initial business plan for the Venture Fund once they finalised its structure. This included the projections of income and costs. The approved Directors fees were not included in the initial draft plan submitted, but were included in the final plan along with the management fees. These projections were submitted to LEDU at the time. The EBT Board discussed and approved any and all payments*".

Abbreviations

C&AG	Comptroller and Auditor General
DFP	Department of Finance and Personnel
EBT	Emerging Business Trust
FSA	Financial Services Authority
IFI	International Fund for Ireland
INI	Invest Northern Ireland
LEDU	Local Enterprise Development Unit
MTF	MTF Chartered Accountants
NDPB	Non Departmental Public Bodies
NIAO	Northern Ireland Audit Office
PAC	Committee of Public Accounts
PWC	PriceWaterhouseCoopers
TPO	Third Party Organisation
VF	Venture Fund

NIAO Reports 2004-2006

Title	NIA/HC No.	Date Published
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