



DERBY CITY COUNCIL

Audit & Risk Management

FINAL AUDIT REPORT
DERWENT NDC: PROJECT APPRAISAL
March 2008



Contact Details:

Richard Boneham
Head of Audit and Risk Management

e-mail:

Tel: 01332 255688

PO Box 6291,
Derby City Council,
Resources Department,
Council House,
Corporation Street,
Derby. DE1 2YL

Final Audit Report Derwent NDC Project Appraisal

Table of Contents

1	Executive Summary	4
1.1	Audit Background.....	4
1.2	Summary of Audit Findings.....	4
1.3	Summary of Recommendations and Control Improvements	4
1.4	Summary of Control Environment Assessment.....	5
2	Introduction	6
2.1	Reason for Audit	6
2.2	Scope of Audit.....	6
2.3	Control Environment Rating.....	7
2.4	Distribution & Communication	8
2.5	Acknowledgments.....	8
3	Control Weaknesses and Recommendations	10
3.1	Project Appraisal Process.....	10
	Recommendation 1.....	11
3.2	Project Information.....	11
	Recommendation 2.....	12
3.3	Project Purpose and Benefits	12
	Recommendation 3.....	13
3.4	Community Involvement	13
	Recommendation 4.....	14
3.5	Project Linkages	14
	Recommendation 5.....	14
3.6	Project Cost / Value for Money	15
	Recommendation 6.....	16
3.7	Project Risk	16
	Recommendation 7.....	17
3.8	Milestones, Monitoring and Management	17
	Recommendation 8.....	18
3.9	Project Evaluation	18
	Recommendation 9.....	19
3.10	Project Sustainability	19
	Recommendation 10.....	20
3.11	Project Options and Selection	20
	Recommendation 11.....	21
3.12	Conflicts of Interest	21
	Recommendation 12.....	23
3.13	Role of Shadow Management Board (SMB)	23
3.14	Power of Appraisal Panel	25
3.15	Proficiency of the Appraisal Panel.....	25
	Recommendation 13.....	26
3.16	Role of the Accountable Body	27
	Recommendation 14.....	28
3.17	Role of Government Office	28



Final Audit Report Derwent NDC Project Appraisal

4	Conclusions.....	30
4.1	Assessment of Control Environment.....	30
4.2	Benefits from Control Improvements.....	30

1 Executive Summary

1.1 Audit Background

- 1.1.1 There have been a number of high profile Derwent Community Team (DCT) project failures and concerns have been raised regarding the administration and management of New Deal for Communities (NDC) funds.
- 1.1.2 In particular, the effectiveness of the project appraisal process has been questioned and whether the appraisal process contributed to the failure of these projects.
- 1.1.3 The appraisal process that was applied to the Derventio Ancient Village Project has been assessed to establish if any control weaknesses existed.

1.2 Summary of Audit Findings

- 1.2.1 The following issues are considered to be the key control weaknesses at the time when the Derventio project was considered, that still reside within the project appraisal system:
- There was no detailed discussion of community involvement.
 - The appraisal panel were unable to produce a robust and objective appraisal that was appropriate to the level of funding and degree of risk involved. The make up of the panel appears to conflict with that approved by the Shadow Management Board (SMB) in August 2001.
 - The Accountable Body failed to ensure that the DCT had adequate systems in operation to appraise and approve projects.

1.3 Summary of Recommendations and Control Improvements

- 1.3.1 This report focuses on the weaknesses in the Council's systems of control that were highlighted by this audit and recommends what Audit considers to be appropriate control improvements. This report contains 14 recommendations, 3 are considered significant, 11 merit attention, and none are considered to be fundamental.
- 1.3.2 All of the control issues within the report have been accepted and positive action has been agreed to be taken to address all issues. The Director of Derwent Community Team has already taken positive action in respect of 1 recommendation and has agreed to take action by May 2008 to address the other recommendations directed to her. This is to include a full governance review of procedures including the application and appraisal process, review of the monitoring framework, evaluation procedures and the DCT Board's constitution, and, the introduction of a risk register, asset register and disposal policy.
- 1.3.3 The Accountable Body have also agreed to take positive action in response to their recommendation and have agreed to confirm arrangements are in place to ensure full compliance with the Accountable Body agreement by mid April 2008.



Final Audit Report Derwent NDC: Project Appraisal

1.4 Summary of Control Environment Assessment

- 1.4.1 From our findings, relative to the scope of this audit, we have determined that the overall level of control was **unsound** at the time of the Derwentio Project appraisal. That means that the risks identified within this audit at that time were major and fundamental improvements would have been required.
- 1.4.2 However, many of the weaknesses stem from the use of an appraisal process that has been superseded by the introduction and implementation of the Project Toolkit in 2006. The Toolkit provides a rigorous process through which projects can be assessed comprehensively which should ensure, if used properly, that only viable projects proceed. The proper use of this tool or other NDC recommended appraisal tools will improve the overall level of control to **satisfactory**. That means that the residual risks identified within this audit are minimal but changes are required.
- 1.4.3 Management and the Audit and Accounts Committee should note that there are no adverse implications for the Annual Governance Statement arising from this work.

2 Introduction

2.1 Reason for Audit

- 2.1.1 Derwent Community Team (DCT) manages the £42 million New Deal for Communities (NDC) government grant which was awarded to the Derwent ward of Derby in April 2002. The partnership involves residents, agencies, voluntary and community sectors, business organisations and staff.
- 2.1.2 Don McLure, Corporate Director – Resources, requested that Internal Audit review the project appraisal process for NDC funded projects delivered through DCT.
- 2.1.3 There have been a number of high profile DCT project failures and the new Director of Derwent Community Team, Jo Andrew, had raised concerns with Don McLure regarding the administration and management of funds. In particular, Jo Andrew was concerned that the project appraisal process was ineffective at the time the projects were approved and this, in conjunction with other control weaknesses, had led to the failure of projects.
- 2.1.4 Projects are funded by DCT to deliver specific outputs as identified in the Delivery Plan. Approval for funding is initially considered by one of five theme groups, then an appraisal panel and finally approved by the Management Board. All are made up of residents, agencies and other stakeholders.

2.2 Scope of Audit

- 2.2.1 In order to evaluate the effectiveness of the project appraisal process, it was necessary to examine the actual appraisal process applied to a failed project and compare this with best practice.
- 2.2.2 The Derventio Heritage Village was selected as an example of a project that had been approved in January 2003, year 2 of the NDC funding stream but was closed in 2007, shortly after opening.
- 2.2.3 This audit focused on establishing the appraisal process applied to the Derventio project, comparing this to Government guidance and best practice and establishing if any weaknesses identified have not yet been resolved by DCT.
- 2.2.4 As much of the information required for the audit relates to 2002, the audit was limited to the records that could be obtained for that period.
- 2.2.5 The following control objectives, taken from best practice guidance, were identified as the key principles that must be applied to the appraisal process:

Separation of Duties

- Project application, appraisal and approval functions should be kept separate and carried out by different people.
- Appraisals should be carried out on behalf of the Partnership by trained individuals who are objective and not involved in the delivery of the proposed project.

Final Audit Report Derwent NDC Project Appraisal

Project Design

- Projects are less likely to encounter difficulties if they have been well designed and developed in consultation with the Partnership.

Technical Knowledge

- Project appraisers need a good understanding of the key issues of project appraisal and may wish to obtain technical support from consultants.

Documentary Evidence

- Appraisal and approval processes should be well documented to ensure that decisions are clear.

Information

- There must be sufficient, accurate information on a project and alternative options before undertaking a project appraisal to avoid badly informed decisions.

2.2.6 A summary of Key Events relating to the Derwentio Project is shown at [Appendix B](#).

2.3 Control Environment Rating

2.3.1 To help management schedule their efforts to implement our recommendations or their alternative solutions, we have risk assessed each control weakness identified in this report. For each recommendation a judgment was made on the likelihood of the risk occurring and the potential impact if the risk was to occur. From that risk assessment each recommendation has been given one of the following ratings:

- Fundamental.
- Significant.
- Merits Attention.

2.3.2 These ratings provide managers with an indication of the importance of recommendations as perceived by Audit; they do not form part of the risk management process; nor do they reflect the timeframe within which these recommendations can be addressed. These matters are still for management to determine.

2.3.3 All fundamental weakness contained in the final versions of audit reports are to be reported to Audit and Accounts Committee together with the management responses as part of Audit and Risk Management's reports to Committee on progress made against the Audit Plan.

2.3.4 All audit reviews will contain an overall opinion based on the adequacy of the level of internal control in existence at the time of the audit. This will be graded as either:

- Good.
- Satisfactory.

Final Audit Report Derwent NDC Project Appraisal

- Marginal.
- Unsatisfactory.
- Unsound.

2.3.5 This will be determined by the number of control weaknesses identified in relation to those examined, weighted by the significance of the risks. Any audits that receive an unsatisfactory or unsound assessment will be highlighted to the Audit and Accounts Committee in Audit's progress reports.

2.4 Distribution & Communication

2.4.1 The draft report has been issued to Jo Andrew, Director of Derwent Community Team. Her comments, in full, concerning each recommendation along with action details, the responsible officer and proposed implementation dates are recounted in the matrix included in Appendix A. We have summarised her responses in the main body after each recommendation.

2.4.2 Our recommendations serve only to provide management with, what Audit considers to be, the most feasible solutions to the control weaknesses identified. The limitations of our scope for each assignment, does not always allow us to identify all the plans and developments that may affect management's decisions on the most appropriate short- or long-term solutions to address the control weaknesses identified. Accordingly, provided that they adequately address the control weaknesses identified, we are happy to accept management's alternative solutions if our recommended actions are not considered the most appropriate remedy. For this purpose we have provided a column in our response matrix to record any such alternative solutions.

2.4.3 This report has been issued to Don McLure, Corporate Director – Resources. Copies of the final report will also be issued to:

- Ray Cowlshaw, Chief Executive.
- Jo Andrew, Director of Derwent Community Team.

2.4.4 This report was produced by [REDACTED] and [REDACTED]. Any enquiry concerning the content of this report or associated issues may be made to [REDACTED].

2.5 Acknowledgments

2.5.1 We would like to take this opportunity to thank those officers who provided us with information and data throughout the duration of this audit and those that have resolved to take action to improve the control weaknesses highlighted by the audit process.

2.5.2 Specifically, we would like to thank:

- Jo Andrew, Director of Derwent Community Team.

[REDACTED]

Final Audit Report Derwent NDC: Project Appraisal

- [REDACTED]

3 Control Weaknesses and Recommendations

3.1 Project Appraisal Process

3.1.1 In April 2002, NDC issued *'Project Appraisal and Approval Guidance'* which was an updated version of guidance issued in 2000. It states that *'the Partnership's Delivery Plan sets out the desired outcomes and vision for the area'* and *'project appraisal is a tool to help partnerships choose the best projects to achieve these outcomes at the best price'*.

All projects should be appraised, but the detail in the appraisal should be proportionate to the level of funding and degree of risk. The guidance sets out in detail the requirements of an appraisal, identifying the information which must be considered. A template is provided in addition the narrative.

This guidance was used by Audit as the measure of best practice against which the Derwentio project was compared.

The NDC Project Appraisal and Approval Guidance and related documents were not used by DCT at the time of Derwentio's appraisal. Although it is acceptable to use other documents designed to fulfil the same purpose, those used by the DCT at this stage were inadequate. The documentation used was that agreed by Shadow Management Board (SMB) in March 2002, but the level of information supplied meant that the NDC requirements were not fulfilled.

The documents examined for the Project Appraisal of Derwentio relied heavily on the Project Application and were not a stand alone summary of key considerations. There was no analysis to support the decisions made and the assumptions relied on from the Project Application were naïve.

In September 2002, the City Council and DCT signed the Accountable Body Agreement which set out the responsibilities and of the Council and DCT. The Agreement covered a number of areas including project approval and appraisal. The agreement states that DCT will be responsible for project appraisal and approval in accordance with NDC guidance. The appraisal did not meet these expected standards.

The Project Appraisal was inadequate when considering the level of funding and the degree of risk associated with the Project. When the Derwentio Appraisal documents were compared to best practice a number of significant weaknesses were evident.

The project appraisal process was revised in 2006 when the Director of DCT designed and implemented *'The Project Toolkit'*. The toolkit is a series of development tools to be used by projects during the development phase of their project.

The toolkit outlines the key principles of a successful development and guides the Development Group through the necessary stages using a series of templates that make up the overall project application. The templates cover key aspects of project appraisal such as funding, risk assessments, sustainability,

Final Audit Report Derwent NDC Project Appraisal

project management skills and project evaluation. It is understood that the toolkit fulfils the requirements of the NDC Project Appraisal and Approval Guidance, if completed to an appropriate standard. Internal Audit has not fully assessed this or other project appraisal toolkits or techniques to determine if they provide an appropriate appraisal mechanism.

Without the use of an appraisal process that fulfils the NDC requirements there is a risk that projects are not appraised appropriately and do not ultimately contribute to the outcomes in the Delivery Plan. There is also the risk that poor appraisal leads to unsustainable projects which damage the reputation of the Accountable Body, DCT and Government Office.

Recommendation 1

Merits Attention

The project appraisal process used to appraise the Derwentio project did not meet the standard set out in the NDC Project Appraisal and Approval Guidance. DCT's project appraisal process has since been revised in 2006 with the introduction of *'The Project Toolkit'*.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project application and appraisal process will be reviewed in line with other NDC's and national best practice.

3.2 Project Information

- 3.2.1 NDC Project Appraisal and Approval Guidance and related documents emphasise that there should be a summary of key facts about the preferred option and contact details. Ideally this should be displayed as a one page front cover for ease of use.

From examining the Derwentio project appraisal documents, we found that many of the key facts were not displayed in a summary cover sheet. The design of the appraisal document did not allow for basic details such as responsible officers, length of project, a brief description of project, total NDC cost and project cost to be identified.

It was expected that the appraisal documentation should present an independent appraisal of the application to help the partnership chose the best project. However, the design of the appraisal documentation did not allow all the elements required in the NDC guidance to be fully completed. The resulting analysis was weak and the robustness of the project had not been challenged. The appraisal was merely a comment on the application form.

Final Audit Report Derwent NDC Project Appraisal

Without full analysis of all the required elements, an objective and robust appraisal can not be undertaken and the projects that best deliver the outcomes in the Development Plan may not be selected.

In the Project Toolkit, the first page requires a project brief, which is summary of what the project will actually do, and contact details for the project. It also requires details of the project's organisation and how the development group will work together. The Project Toolkit has not been appraised in light of best practice but appears to offer a significant improvement to the previous process.

Recommendation 2

Merits Attention

The level of detail completed in the project appraisal documentation for the Derwentio Project was insufficient and the form did not allow for a summary of key facts. The appraisal offered no in-depth analysis and was merely a comment on the Project Application form. From 2006, *'The Project Toolkit'* requires the production of a project brief.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to the provision of information, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project application and appraisal process will be reviewed in line with other NDC's and national best practice.

The review will include the provision of information to support the appraisal function.

3.3 Project Purpose and Benefits

- 3.3.1 NDC best practice guidelines emphasise that there should be a description of why there is a need for the project, what problems it aims to tackle and how it contributes to meeting the outcomes set out in the Delivery Plan. If a project does not contribute to meeting Delivery Plan outcomes it should not receive NDC funding.

From examining the Derwentio project appraisal documents, we found that the project appraisal did not quantify any outcomes. Despite the form having boxes to state numbers for each strategic goal and related output, these have not been completed. Each strategic goal was ticked but no detail provided. The section did not refer to the project application or Delivery Plan. The project application did contain some information on outputs, but this was not substantiated. A comment on the appraisal form did question whether the output for school visits was realistic, but no supporting evidence appears to have been obtained. The need for the project and the long term impact on the NDC neighbourhood was not documented in the project appraisal.

Final Audit Report Derwent NDC Project Appraisal

It was expected that the appraisal documentation would demonstrate what problems were being tackled and how the project would contribute to meeting the outputs set out in the Delivery Plan. Without a full assessment of the outcomes and outputs it is impossible to demonstrate the projects contribution, and there is a risk that the SMB may approve projects that do not contribute to the Delivery Plan.

Section two of the Project Toolkit discusses needs, outcomes and solutions, identifying what problems the project is trying to address and how the project will help to achieve this. It also requires other options to be considered and confirmation of why the preferred option was chosen. The Project Toolkit has not been appraised in light of best practice but appears to offer a significant improvement to the previous process.

Recommendation 3

Merits Attention

At the time when the Derventio project was considered, the project appraisal did not quantify any outputs or demonstrate how it contributed to the Delivery Plan. From 2006, *'The Project Toolkit'* discusses needs, outcomes and solutions.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to project purpose and benefits, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project application and appraisal process will be reviewed in line with other NDC's and national best practice.

The review will include the assessment of a project's contribution to the Delivery Plan.

3.4 Community Involvement

3.4.1 NDC best practice guidelines emphasise that the community involvement section aims to demonstrate the relevance of this project to local people and ensure that all local groups are involved in the project.

From examining the Derventio Project Appraisal documents, we found that the Project Appraisal mentions only that there was a *'clear target group'* and that it *'appears to have an equal opportunities policy'*. There was no discussion of the brief information contained in the application form. A copy of the equal opportunities policy was not provided.

Without being able to demonstrate that the project involves local people and takes account of the needs of people from minority groups, there is a risk that stakeholders may not be adequately represented or particular groups have been

Final Audit Report Derwent NDC: Project Appraisal

excluded which could result in projects that are not relevant to all local groups and adverse criticism for the project.

Recommendation 4

Significant

At the time when the Derventio project was considered, there was no detailed discussion of community involvement.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to community involvement, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project appraisal process will be revisited and form part of an overall review of governance arrangements for the NDC programme.

Future projects will be required to demonstrate their relevance to local people and ensure that local groups are involved in the project.

3.5 Project Linkages

- 3.5.1 NDC best practice guidelines emphasise that the appraisal should identify how the project links into others which are operating locally to avoid duplication and to add value.

From examining the Derventio project appraisal documents, we found that there was no mention of Derventio linking with other projects in the area or involving any other partners. Some reference was made to working with other steering groups in the project application but regional and local strategies were not discussed.

Without being able to identify how the project links in with others which are operating locally there is a risk that the Partnership may have some elements of duplication or the project may conflict with other regional or local strategies.

Section five of the Project Toolkit reviews the projects integration with other activities. The relationships with other organisations are reviewed in an attempt to identify activity which may be duplicated. The Project Toolkit has not been appraised in light of best practice but appears to offer a significant improvement to the previous process.

Recommendation 5

Merits Attention

At the time when the Derventio project was considered, there was no discussion of links with other partners operating locally or regional or local strategies. From

Final Audit Report Derwent NDC Project Appraisal

2006, 'The Project Toolkit' includes a review of the projects integration with other activities.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to the linkages, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The application process will be revised to ensure that applicants demonstrate how their activities/projects integrate with other services in the community and how projects complement mainstream provision.

3.6 Project Cost / Value for Money

3.6.1 NDC best practice guidelines emphasise that the total cost of the project and sources of funding should be identified. Value for money should be considered as should potential increases in costs. The appraisal must demonstrate whether NDC funding is needed and the total cost to the NDC.

From examining the Derwentio project appraisal documents, we found that the project appraisal offered no analysis of funding, costs, cash flow or comparison with other similar projects. It merely raised questions regarding the Project Manager's salary and whether staffing costs and work wear costs were realistic. Although it did not refer to the project application it was discussing the costs itemised in this document. However, even in the project application there was little substantiation or justification for these costs.

The analysis of funding in the appraisal document consisted of '*it is hoped once the project is established that they will be able to attract funding*'. This, at best, was ill considered and naïve on a project seeking funding of approx £¾m. The funding package detailed in the project application is difficult to follow as it is crossed through in a number of places and the status of the applications for other funding, were not detailed.

There was insufficient consideration and analysis given to the income assumptions set out in the project application. The income projections were based on estimated attendance figures. Sensitivity analysis had not been used to vary the basic assumption on which the viability of the project depended. Therefore the robustness of the success of the project had not been challenged.

It is the Partnerships responsibility to ensure that required information is received prior to or as part of the appraisal. A Business Plan was mentioned at the Shadow Management Board on 30 January 2003 that approved the project, but there is no evidence to suggest that it had formed part of the appraisal for the Derwentio project.

Although the Project Application form has not been scrutinised as part of this audit, it was noted that the independent referee sought on application was not

Final Audit Report Derwent NDC Project Appraisal

provided. [REDACTED] had undertaken the financial verification for the Project Application, but there is no evidence to suggest that [REDACTED] had the appropriate skills to do this.

Without appropriate analysis of costs and income it is impossible to determine if the project is viable, needs NDC funding and represents good value for money assessment. Without adequate analysis there is a risk that projects will be approved that are not financially viable, do not need NDC funds or do not offer value for money.

Section eight of the Project Toolkit identifies how the funding requirements should be identified, drawn together and profiled. There are several exercises to complete to ensure all the funding requirements are identified. The Project Toolkit has not been appraised in light of best practice but appears to offer a significant improvement to the previous process.

Recommendation 6

Merits Attention

At the time when the Derventio project was considered, there was no robust analysis of funding, costs, cash flows or comparison with similar projects. From 2006, *'The Project Toolkit'* identifies how the funding requirements should be identified, drawn together and profiled.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to identification of cost and value for money, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project appraisal process will be re-visited and form part of an overall review of governance arrangements for the NDC programme. This will include crucial issues such as financial analysis and VFM.

3.7 Project Risk

3.7.1 NDC best practice guidelines emphasise that the project appraisal should identify the issues that would stop the project achieving its objectives and how those risks could be mitigated. The risk should be assessed in terms of risk to project delivery and risk of loss of benefit to the area.

From examining the Derventio project appraisal documentation, we found that the appraisal didn't analyse any of the risks it merely commented that 'the risks appear realistic, but should have thought about funding not coming through.' The risks identified in the project application were very brief and do not cover fundamental issues in any detail such as loss of funding, incorrect income assumptions, inability to become sustainable at the end of the funding period, delays to the project, poor project management etc.

Final Audit Report Derwent NDC: Project Appraisal

Without a comprehensive review of risks and identification of the ways to overcome them, the Partnership has not considered any events or circumstances which could jeopardise or reduce the effectiveness of the project. This could result in significant financial or reputational loss to all members of the Partnership.

The Project Toolkit gives guidance on how to undertake a risk assessment on each project. It also requires the project team to consider how they will evaluate and manage the risks that they have identified. The Project Toolkit has not been appraised in light of best practice but appears to offer a significant improvement to the previous process.

Recommendation 7

Merits Attention

At the time when the Derwentio project was considered, an appropriate risk assessment was not produced. From 2006, *'The Project Toolkit'* provides guidance on how to undertake a risk assessment on each project.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to risk, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

A risk assessment register will be introduced as part of the governance arrangements for approval and management of projects that are approved for NDC funding.

Individual risks will also be comprehensively assessed for each project as part of the approval process.

3.8 Milestones, Monitoring and Management

- 3.8.1 NDC best practice guidelines emphasise that the appraisal document should ensure that appropriate management arrangements are in place for the project. Key milestones and monitoring arrangements should be analysed to ensure that they are robust and accurately reflect the progress made by the project in order to contribute to a successful delivery.

From examining the Derwentio project appraisal, we found that the project appraisal included only brief comments such as *'milestones appear realistic'*. There was some detail in the project application but this was superficial, with no depth or analysis to support the comments made. The Project Management described in the project application lists all the funding secured by the management organisation. However, the highest value of funding secured was only £10,000 and is not comparable with the funding requested.

Final Audit Report Derwent NDC Project Appraisal

Monitoring the projects progress allows management to take corrective action if the project goes off course. Without adequate monitoring arrangements decisions will not be taken to identify and correct progress. This could lead to the project suffering financial loss or not achieving the stated outcomes.

The Project Toolkit suggests managing the project by using a project development process that outlines the key considerations and tasks necessary to deliver a successful project. It also identifies the standard outcomes that DCT monitor. These are outputs specified by Government Office as they contribute towards the long term objectives of the NDC programme. The Project Toolkit has not been appraised in light of best practice but appears to offer a significant improvement to the previous process.

Recommendation 8

Merits Attention

At the time when the Derwentio project was considered, there was no evidence that monitoring arrangements had been analysed to ensure that they were robust and would accurately reflect the progress made by the project. The management arrangements were not evaluated in any detail. From 2006, *'The Project Toolkit'* outlines the key considerations and tasks necessary to deliver a successful project.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to the monitoring and management of projects, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

A full review of the governance framework will be completed to ensure compliance with the NDC grant conditions. This will include a review of the monitoring framework linked to the delivery of outcomes.

3.9 Project Evaluation

3.9.1 NDC best practice guidelines emphasise that the Project Appraisal should consider how the success or otherwise of the project is linked into the wider evaluation of the NDC programme in the area.

From examining the Derwentio Project Appraisal, we found that there was not a specific requirement in DCT appraisal documents to disclose how the project will be evaluated.

Without project evaluation there is no measure of how successful aspects of the projects were or of passing on the lessons learned to future decision makers. Without project evaluation future decisions could be uninformed and the effectiveness of the Partnership reduced.

Final Audit Report Derwent NDC Project Appraisal

DCT has developed a comprehensive project evaluation process which is specifically for use on projects funded by NDC. Three different options are available to evaluate each project. These options have not been assessed in light of best practice but appear to offer a significant improvement to the previous process.

Recommendation 9

Merits Attention

At the time when the Derwentio project was considered, there was not a specific requirement in DCT appraisal documents to disclose how the project was to be evaluated. From 2006, *'The Project Toolkit'* describes a comprehensive project evaluation process.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to evaluation, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

This will form part of the governance review process. A new evaluation process will be introduced that satisfies the NDC conditions of grant.

3.10 Project Sustainability

3.10.1 NDC best practice guidelines emphasise that one of the objectives of the NDC funding stream is to ensure that when the funding is withdrawn the benefits of the project can continue. The project appraisal process should establish what will happen when the project finishes and whether mainstream service providers will build the project into their service.

From examining the Derwentio project appraisal, we found that the future was not considered in the appraisal document. The only comment under the forward strategy box was *'self sustainable, eventually'*. The project application stated that the project will be sustainable through income and sales once the funding has been withdrawn but these figures were not substantiated. There was insufficient consideration and analysis given to the income assumptions. The income projections were based on estimated attendance figures but these had not been subjected to sensitivity analysis yet were the linchpin on which the viability of the project depended. Therefore the robustness of the success of the project had not been challenged.

Where the sustainability of a project has not been fully considered there is a risk that the project will fail during the funding period or after the funding has come to an end. This could result in significant financial and reputational loss to the Partnership.

Final Audit Report Derwent NDC Project Appraisal

The Project Toolkit describes sustainability as '*one of the biggest tests you will face as a Development Group and is the single biggest concern of DCTThe DCT Board is adamant that without sustainability, projects will not receive funding.*' It then goes on to describe the possible options for analysing the sustainability of a project. The coverage in the Project Toolkit is comprehensive and appears to be a significant improvement to the previous project, but it has not been appraised in light of best practice.

Recommendation 10

Merits Attention

At the time when the Derwentio project was considered, the future of the project was not considered and the sustainability assumptions were naïve. From 2006, '*The Project Toolkit*' describes possible options for analysing the sustainability of a project.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to sustainability, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project appraisal process will be re-visited and form part of an overall review of governance arrangements for the NDC programme. The review will consider sustainability and mainstreaming of projects.

3.11 Project Options and Selection

3.11.1 NDC best practice guidelines emphasise that the appraisal should consider the other options that were considered and why they were rejected in favour of the preferred option. Other options should be rigorously assessed to ensure that the best option has been chosen. The main reason for selecting the preferred option should then be clearly set out. The recommendation to approve the project should be signed and dated by the appraisers and the reasons for the recommendation stated.

From examining the Derwentio project appraisal, we found that the Appraisal Panel stated that '*the project outlined appears to be the most appropriate for this project*'. It made no comparison with other options for the site. We found that there was no explanation on the Appraisal document as to why the preferred option has been selected and that there were no reasons stated for the recommendation to approve the project.

If the panel cannot demonstrate that the best option has been chosen then the objectivity, transparency and openness of the decision making process may be challenged.

As described in section three, the Project Toolkit requires that consideration of other options and the selection of the preferred option is documented.

Recommendation 11

Merits Attention

At the time when the Derwentio project was considered, the main reasons for selecting the preferred option were not documented. No reasons were stated on the appraisal documentation as to why the project was supported by the panel. From 2006, *'The Project Toolkit'* requires the consideration of other options and that the selection of the preferred option is documented.

We recommend that the Director of Derwent Community Team ensures that all future project appraisals comply with the minimum standards set out in the NDC guidance and best practice in relation to option selection, and that adherence to the standards is monitored.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project appraisal process will be re-visited and form part of an overall review of governance arrangements for the NDC programme.

3.12 Conflicts of Interest

3.12.1 In September 2003, guidance was issued on Codes of Conduct for NDC partnership board members, which covered the importance of a conflict of interest policy. All NDC's were asked to check that their existing codes covered the issues adequately.

In 2004, the Office of the Deputy Prime Minister (ODPM) issued Programme Note 25 *'Transformation and Sustainability'* which discussed Governance for the NDC Programme. The note stated that the National Audit Office recommended that Governance arrangements should be urgently reviewed and strengthened for some NDC partnerships. It acknowledged that when the NDC Programme was set up no specific guidance was provided on the constitution or governance of partnerships and sighted poor governance to be a major cause of problems in NDC partnership which have experienced difficulties in delivering their programmes.

DCT staff, members of the Board and other decision making forums have a duty of care and obligation to act in the best interests of the NDC Programme. NDC Finance Guidance states that 'Officers, members and employees of the Partnership must be careful to avoid conflicts of interest. The Accountable Body must ensure that the Partnership agrees formal, written procedures for the avoidance of conflicts of interest by members, employees and officers of the Partnership in connection with any decision-making under the Delivery Plan. This must involve a duty to declare any conflicts of interest at project appraisal or approval stages.'

It is expected that where a conflict of interests exist, appropriate action will be taken to ensure that no undue influence has been exerted or that any improper actions have been taken.

Final Audit Report Derwent NDC Project Appraisal

Within the appraisal process it is expected that there is a clear separation of duties between the application, appraisal and approval functions. The roles associated with each must be kept separate and carried out by different people to show that decisions have been taken properly. The decision making criteria must be robust and the process transparent to ensure that the preferred option is the best for the area and not someone's 'pet' project.

The Derwentio Ancient Village Project was the idea of Eddie Buckley, a Derwent Resident, who was active in the local community and had undertaken a number of local projects. In the Outline Project Application for the Derwentio Project it lists him as the Acting Chairperson for the Community Empowerment and Capacity Building Theme Group, the Vice Chairperson for the Derwent Sport Action Group and a panel member for the Catalyst Fund and the Community Initiatives fund.

He was also listed as a member of the Lifelong Learning and Young People Theme Group at the time of the projects approval by the group. As he had already taken a lead role in community activities it had allowed him to form relationships with group members, and whilst he was allowed to be present for any discussion and vote, it allowed him undue influence on the outcome of their decisions.

The Appraisal panel had three members. In the project application it mentioned one of the appraisers as having links with the project. Although, it is expected that projects must involve the community and have appropriate links with other projects, the appraiser should be independent and have no vested interest in the success of the project.

The make up of the appraisal panel did not comply with that specified by the SMB minutes for August 2001. (3.14 refers)

Eddy Buckley became the Derwentio project manager. He was listed as a Board Member of the Shadow Management Board Meeting that approved the full Derwentio project application. He was present at the meeting and was asked to give more information on the project. Although he declared an interest in the item, the minutes do not record him leaving the meeting whilst the item was discussed or voted on. As he was known to most members of the panel he could influence members of the panel through their prior relationship with him.

The SMB's draft Terms of Reference covers the issue of conflicts of interests stating: *'At each meeting, members of the Management Board:*

- *Must declare any financial and personal interests*
- *Must leave the meeting if they have declared a financial interest*
- *Can, if permitted by the chair, remain in a meeting after declaring a personal interest, take part in discussions and vote.'*

This is contradictory to the Accountable Body Agreement that states:

Final Audit Report Derwent NDC Project Appraisal

'Where a person's interest in a matter is of a financial nature or is one which a member of the public knowing the relevant facts would regard as so significant as to prejudice the person's judgement of the matter, that person shall:

- Withdraw from the meeting while the matter is being considered and not take part in any discussion of that matter.*
- Not seek to improperly influence any decision relating to that matter.*
- Not vote on that matter.'*

The conflicting expectations are not helpful, but clearly where the applicant is a member of the group and allowed to remain in the room whilst discussions and voting takes place, it enables them to be able to influence the outcome of whether a project should be approved and funded. The appraisal process is not objective where an applicant is allowed undue influence on decision making forums.

Where there are no clear governance arrangements there is a risk that a conflict of interest will not be managed effectively and individuals may be allowed to influence decision making forums.

A conflict of interest policy was introduced in 2007 by the Director of DCT. It is Managements responsibility to ensure that the policy is applied.

Recommendation 12

Merits Attention

At the time when the Derventio project was appraised there were clear conflicts of interest that were not appropriately managed. A conflict of interest policy was introduced in 2007.

We recommend that Director of Derwent Community Team ensures that the conflict of interests' policy is applied as intended, in line with best practice.

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

A conflict of interest policy has been introduced and implemented. Its use will be monitored to ensure that it is applied as intended.

3.13 Role of Shadow Management Board (SMB)

3.13.1 In relation to the project appraisal process it is the responsibility of the NDC Partnership to ensure that each project is appraised and approved according to the NDC project appraisal and approval guidance.

The SMB minutes and reports have been reviewed and it has been established that the roles and responsibilities of the appraisal and approval process were clearly set out for members and other stakeholders.

Final Audit Report Derwent NDC: Project Appraisal

The terms of reference for the Derwent NDC Theme Groups (Item 15 Shadow Management Board 15 October 2001) stated two of their principal purposes as:

- To facilitate the development of projects that will be delivered in accordance with the principles of NDC, designed for the purpose of residents and sustainable post-NDC funding.
- To endorse or reject project outline application for inclusion in the NDC programme.

The role of the Shadow Management Board in approving projects was the subject of a report on 15 October 2001. The introduction identified the distinct role of the SMB and went on to discuss the factors to be taken into account when approving projects. The separation of duties was highlighted by quoting the NDC Project Appraisal and Approval guidance as *'The formal decision to approve a project must be taken by people who have not been involved in the project development or appraisal processes.'* The report stated that approval should only be granted where:

- The appraisal panel has recommended it.
- The project fits the Strategic Plan.
- Funding is available.
- Outputs and outcomes are commensurate with the amount of funding granted and will compliment other activity.

The roles and responsibilities identified outline how crucial the actual appraisal of projects is to their eventual approval and success. The projects are approved by the Theme Group if the basic requirement is met and the appraisal panel is there to undertake a robust analysis of the project and should be a stand alone summary of the key facts that demonstrate why and how a decision was reached.

On 21 March 2002, a report was presented to the SMB that revised the application and appraisal process. It introduced a number of changes that were summarised as:

- Clarification of roles of Theme, Appraisal and SMB with regard to the functions of appraisal.
- Extend 'Outline' form with an increased emphasis on development and involvement of Derwent Community.
- Reduced 'Application' form that now deals primarily with technical issues.
- More extensive and clearer guidance notes for applicants that will include an 'example' form.
- Full appraisal form that audits the process across all three stages of application.

These documents were used to appraise the Derwentio project but did not fulfil NDC requirements.

3.14 Power of Appraisal Panel

3.14.1 The role of the appraisal panel was discussed at the Shadow Management Board on 15 August 2001. It was agreed that the panel should consist of six members made up of three residents and one of each representative from public, private and voluntary sectors. There should be a minimum of four votes needed to pass an application for funding. When questioned regarding how much authority would be given to the pre-appraisal sifting the Project Co-ordinator for DCT commented that *'the process would be such that , prior to appraisal, applications would only be put forward if they fulfilled very basic criteria, such that they fitted into our overall aims and objectives. This step would be discussed at the outline application stage and at the theme group meetings. If more than one outline application were received for a similar project, this would be the time to link the projects. **The only time applicants would be rejected or sent back for more information, prior to appraisal, would be if the application form was not completed fully or correctly: a judgement would not be made on content prior to appraisal.**'*

The Chair commented that technical advisors could be called at any time and that applicants can be invited to the appraisal panel where it is deemed necessary. It was also noted that the approval stage should not be a re-appraisal, but the opportunity to question or clarify decisions: and not just seen as a rubber stamping exercise.

The Derwentio Project was appraised on the same day as the SMB met and approved the application. When the Programme Manager was asked about this he commented *'the fact that the project was appraised and approved at the Board on the same day is indicative of the culture at DCT at the time, as projects were forced through the system. The appraisal panels were unable to reject projects, once they had been approved by the Theme Group the project had to go to the Board. the appraiser's comments on the project illustrates the residents' enthusiasm for the project.'*

If this was the case, initial applications were only rejected prior to appraisal if they were not fully completed and the appraisal panel were unlikely to reject projects. This left only scrutiny from the SMB that could lead to the rejection of a project.

3.15 Proficiency of the Appraisal Panel

3.15.1 It was expected that Appraisal Panel members were appropriately trained and experienced in order to undertake the detailed analysis required in a project appraisal. In the review of the Derwentio appraisal, it was found that the panel was made up of three members who had received training delivered by an external trainer in the summer of 2001. The Programme Manager commented that he felt that the appraisal team were experienced. No comment appears to have been made by the Partnership that the appraisal panel membership was not as approved by SMB, highlighted previously. (3.14)

The NDC Project Appraisal and Guidance states that *'the level of detail in your appraisal should be proportionate to the level of funding and degree of risk.'*

Final Audit Report Derwent NDC: Project Appraisal

When the Theme Group discussed the Derwentio Project they discussed the enormity of the project and the fact that they were aware of similar projects that had failed due to a lack of sustainability.

More recent guidance from NDC states that when appraising a project if the capital costs exceed £500,000 technical advice should be sought as part of the appraisal. Independent advice on design and construction should be sought and relevant information should be submitted to Government Office before their approval is obtained. Although this was not a NDC requirement at the time that Derwentio was appraised, without a suitable architect or surveyor to provide advice on the capital proposals it is unlikely that the appraisal panel would have been able to make an informed judgement as to the risks associated with capital works. The SMB had also referred to the use of external advisors for appraisal panels, but did not note that they hadn't been used in the appraisal.

The Appraisal Panel did not demonstrate that a thorough appraisal had been undertaken, even though they were given training and were aware of the level of funding and risk associated with the project. The resulting narrative on the project appraisal was very brief and there appears to be little understanding of the requirement to produce an in depth analysis of the application. This is evidenced by the appraisal being completed on the same day as it was approved by the Shadow Management Board.

There is no evidence to suggest that the Shadow Management Board were unhappy with the analysis provided through the appraisal process although they did ask for some further information on the project at the meeting.

Where the appraisal panel cannot produce a robust and objective appraisal for each project, there is a risk that unworthy or 'pet' projects will be approved.

Recommendation 13

Significant

At the time when the Derwentio project was considered, the appraisal panel were unable to produce a robust and objective appraisal that was appropriate to the level of funding and degree of risk involved. The make up of the panel appears to conflict with that approved by the SMB in August 2001.

We recommend that the Director of Derwent Community Team seeks clarification of the membership of the panel from the Management Board and that a training programme for panel members is delivered to ensure that they have appropriate skills and understand the importance of the appraisal panel's role.

Final Audit Report Derwent NDC: Project Appraisal

Response from Jo Andrew, Director of Derwent Community Team

Issue Accepted

The project appraisal process will be re-visited and form part of an overall review of governance arrangements for the NDC programme.

A new process will be introduced whereby projects are appraised by a panel of three including a technical expert / project manager, finance manager and representative from DCT. A representative from the Accountable Body will be invited to attend where projects exceed £100k.

3.16 Role of the Accountable Body

3.16.1 It is for the Accountable Body to satisfy itself that the NDC Partnership is properly constituted, has the right people in place, and systems that provide for regularity and propriety. The Council's role as Accountable Body means that it enters into legal agreements on behalf of the partnership, acts as a banker, is responsible for the financial probity of the funding and is potentially liable for repaying funding should the terms of the agreement be breached.

In relation to the project appraisal process it is the responsibility of the Accountable Body to ensure that the Partnership has adequate systems in place to appraise and approve the project and check on a sample basis that these systems are being used.

The Accountable Body had a representative on the SMB who regularly attended the SMB meetings at which the projects were finally approved. No evidence has been found to suggest that the non-compliance with NDC guidance was challenged. Accountable Body efforts were concentrated on ensuring adequate management and monitoring systems were in place once the project was underway.

In the case study analysed, the Accountable body offered help and guidance in to the initial set up of the Derwentio project as many weaknesses had been noted in the early systems' reviews and monitoring visits.

The progress of the NDC was reported as an external funding stream to Cabinet, but it was noted that DCT sat outside the Accountable Body's Departmental reporting structure and it is uncertain how effective the Accountable Body's management of the relationship was.

The Accountable Body assumed a relatively low level of control and believed it had ensured that the Partnership had adequate systems in place to appraise and approve projects as the responsibilities had been clearly outlined to all parties in the Accountable Body Agreement.

Without the Accountable Body ensuring that adequate appraisal systems are in operation and being used as intended, there is a risk that DCT is able to use ineffective processes.

Recommendation 14

Significant

At the time when the Derwentio project was considered in January 2003, the Accountable Body failed to ensure that the DCT had adequate systems in operation to appraise and approve projects.

We recommend that the Accountable Body reviews its role and obligations in the Partnership. In particular it should review the Accountable Body Agreement to ensure that it has met its responsibilities and that there are mechanisms in place to ensure they are being adhered to.

Response from Don McLure, Director of Resources

Issue Accepted

The Head of Finance – Regeneration and Community will start this review as soon as possible during March 2008 and produce a written report confirming arrangements are in place to ensure full compliance with the Accountable Body agreement by mid April 2008.

3.17 Role of Government Office

3.17.1 In April 2001, a conditional offer of funding was received from the Department of the Environment, Transport and the Regions to approve NDC grant of £38 million towards the achievement of objectives set out in the Delivery Plan. Paragraph six of the letter states that *'Evidence suggests that without good and rigorous project appraisal, the expected benefits of any scheme or project risk failing to materialise. Therefore, prior to the approval of any projects for NDC grant, you must ensure that the necessary consents are in place for the proposed activities. In addition, GO will need to be satisfied that your Partnership can undertake project appraisals in accordance with NDC requirements. from GO will contact you shortly to discuss the implications of the requirement for your Partnership. This may involve your Partnership:*

- (a) providing examples of project appraisal as evidence of compliance; or*
- (b) undertaking the Department's Distance Learning Programme on Project Appraisal.*

Contact GO for details; or

- (c) initially being given a lower project delegation limit to the maximum £250k.'*

Final approval for the NDC funding was received in April 2002. Therefore Government Office must have been satisfied at this time that the Partnership could undertake project appraisal in accordance with NDC requirements.

In relation to the project appraisal process it is the responsibility of Government Office to approve projects over the Partnerships delegation level.

A representative from GOEM was present at the Shadow Management Board meeting that approved the Derwentio Project. A letter was received from GOEM dated 8 May 2003 confirming their approval of the Project. Approval was given



Final Audit Report Derwent NDC: Project Appraisal

for capital funding up to £671,000 and revenue funding up to £188,500 for those activities assigned to 2003/04 as described in the project application.

There is no evidence on the project file to suggest that GOEM sought any further analysis of the application before approving it and were therefore satisfied with the information provided.

4 Conclusions

4.1 Assessment of Control Environment

- 4.1.1 From our findings, relative to the scope of this audit, we have determined that the overall level of control was **unsound** at the time of the Derwentio Project appraisal. That means that the risks identified within this audit at that time were major and fundamental improvements would have been required.
- 4.1.2 However, many of the weaknesses stem from the use of an appraisal process that has been superseded by the introduction and implementation of the Project Toolkit in 2006. The Toolkit provides a rigorous process through which projects can be assessed comprehensively which should ensure, if used properly, that only viable projects proceed. The proper use of this tool or other NDC recommended appraisal tools will improve the overall level of control to **satisfactory**. That means that the residual risks identified within this audit are minimal but changes are required.
- 4.1.3 Management and the Audit and Accounts Committee should note that there are no adverse implications for the Annual Governance Statement arising from this work.

4.2 Benefits from Control Improvements

- 4.2.1 If management implement their proposed actions to address our recommendations and resolve the control weaknesses highlighted in our findings, it could be said that :
- Future projects will undergo a robust appraisal and approval process that complies with NDC guidance and best practice.
 - The conflict of interest policy introduced by Jo Andrew in 2007 will be reviewed to ensure that it is being applied as intended. Its effective operation should ensure that further conflicts of interest do not arise.
 - The membership of the Appraisal Panel will be clearly defined and the members will be sufficiently empowered to make informed decisions.
 - The Accountable Body will be able to ensure that it has fulfilled its responsibilities in the Partnership.
- 4.2.2 All of the control issues within the report have been accepted and positive action has been agreed to be taken to address all issues. The Director of Derwent Community Team has already taken positive action in respect of 1 recommendation and has agreed to take action by May 2008 to address the other recommendations directed to her. This is to include a full governance review of procedures including the application and appraisal process, review of the monitoring framework, evaluation procedures and the DCT Board's constitution, and, the introduction of a risk register, asset register and disposal policy.



Final Audit Report Derwent NDC: Project Appraisal

- 4.2.3 The Accountable Body have also agreed to take positive action in response to their recommendation and have agreed to confirm arrangements are in place to ensure full compliance with the Accountable Body agreement by mid April 2008.
- 4.2.4 We will endeavour to follow up the implementation of our recommendations, or any agreed alternative actions, with the relevant responsible officers, as soon as is practicable, after the target implementation dates.