House of Commons

Committee of Public Accounts

Governance issues in the Department of Enterprise, Trade and Investment's former Local Enterprise Development Unit

Forty–sixth Report of Session 2005–06

HC 918

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Report, together with formal minutes, oral and written evidence

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The Committee of Public Accounts

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Summary

This is one of the worst cases of conflict of interest and impropriety that this Committee has seen. The Department of Enterprise, Trade and Investment has a history of inadequate oversight of its non-departmental public bodies and there has been a series of Reports[1] by the Assembly Public Accounts Committee and the Comptroller and Auditor General (C&AG), dealing with failures of governance. This latest case plumbed new depths in the extent to which the Department failed to ensure that the basic principles of the proper conduct of public business were observed.

LEDU was an NDPB of the Department and was Northern Ireland's small business agency. The Emerging Business Trust (EBT) was set up in 1996 to provide loans and, from 2000, equity finance for small businesses. It received £4.35 million of public funds, including £0.95 million from LEDU. EBT went into voluntary liquidation in 2005. A forensic investigation into EBT's activities, commissioned by Invest Northern Ireland in 2003, revealed extensive failures of governance, particularly relating to conflicts of interest.

In grant-aiding EBT, LEDU contributed to the formation of an organisation that substantially benefited the Deputy Chair of its own Board, Mrs Teresa Townsley. The accountancy practice in which Mrs Townsley and her husband were the only partners was appointed, without proper tendering, as managers of EBT, receiving £1.4 million in fees between 1997 and 2005. Mrs Townsley was also appointed to the Board of EBT. There were also extensive conflicting relationships between Mrs Townsley, her husband and a number of companies supported by EBT.

LEDU provided no guidance on how potential conflicts of interest involving EBT's managers and its clients should be handled. The senior LEDU official, acting as its representative on the Board of EBT, failed to raise any concerns. At almost every stage of the project, there was a dismal failure within LEDU to apply normal controls and procedures over purchasing, project appraisal and monitoring.

The Department must have been aware of weaknesses within LEDU and certainly had knowledge of EBT, but these problems continued for seven years before any action was taken. Most worryingly, the Department knew of the conflicts of interest inherent in the multiplicity of roles involving Mrs Townsley but, to our astonishment, took no action.

On the basis of a Report by the C&AG,[2] the Committee took evidence from the Department and Invest Northern Ireland (which took over LEDU's responsibilities in April 2002) on the extent of the conflicts of interest in the establishment of EBT; the conflicting relationships between EBT managers and client companies; the unsatisfactory nature of LEDU's monitoring of EBT; and failings in the Department's oversight of LEDU.

1 11th Report from the Committee of Public Accounts, Northern Ireland Assembly, *LEDU internal fraud* (NIA 11/01/R, Session 2001–02); Northern Ireland Appropriation Accounts 1997–98, *Department of Economic Development, Vote 2: Other economic support measures, administration, energy and miscellaneous services*; 11th Report from the Committee of Public Accounts, House of Commons, *Selective financial assistance for tourism in Northern Ireland* (HC 266, Session 1995–96); 1st Report from the Committee of Public Accounts, Northern Ireland Assembly, *Report on the Northern Ireland Tourist Board* (NIA 01/02/R, Session 2002–03).

2 C&AG's Report, *Governance issues in the Department of Enterprise, Trade and Investment's former Local Enterprise Development Unit*, (HC 817, Session 2005–06).

Conclusions and recommendations

1. **One of the most depressing features of this case is that the taxpayer was let down by almost everyone in the chain of responsibility for ensuring proper conduct in relation to EBT.** Departments must ensure that their NDPBs and any third party organisation funded by them observe the basic controls and procedures on which confidence in public administration depends. The Department allowed LEDU to operate year after year outside acceptable standards of public administration. This was a dereliction of its responsibility to ensure that the financial and other management controls being applied by LEDU conformed to the requirements both of propriety and good management.

2. **LEDU's problems resulted from a culture which seems to have had no respect for the proper conduct of public business.** The new Accounting Officer referred to the 'arms length relationship' between the Department and its non-departmental public bodies (NDPBs) as an explanation for the problems encountered in LEDU. Although this relationship was seriously flawed, the Committee agree with the Assembly's PAC that the problems went beyond the structural framework to the very culture and ethos of these bodies. In another of the Department's NDPBs the Assembly PAC found "a culture of apathy, incompetence and lack of respect for proper procedures at the top of the organisation. Aspects of this culture appear to extend right to the heart of the Department itself." This judgement applies equally to LEDU. The Department and its NDPBs need to recognise the scale of the culture change that is necessary.

3. **The Department now faces an enormous challenge to restore parliamentary and public confidence in its governance arrangements. Against this background it is not sufficient to try to do better, the Department and its NDPBs must aim to be beyond reproach.** Northern Ireland is a relatively small society where close connections between senior civil servants and those who serve on Boards of public bodies is inevitable. In these circumstances it is particularly important to be sensitive to the need to avoid any perception of conflict of interest or impropriety. The Department must ensure that only the highest standards of ethics and propriety operate in bodies under its control.

4. **We are in no doubt that the mishandling of this case could have been prevented if the advice in our report on the Proper Conduct of Public Business[3] had been taken seriously by the Department of Enterprise, Trade and Investment.** Departments need to ensure that PAC recommendations are fully communicated to those on the front line and are put into effect.

5. **This is a case where every one of Lord Nolan's seven principles of public life have been breached – Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty and Leadership.** Mrs Townsley had accepted a number of positions of responsibility where a commitment to the principles of public service was essential. She is a Chartered Accountant and, therefore, required to operate within a

3 8th Report from the Committee of Public Accounts, *The proper conduct of public business* (HC 154, Session 1993–94)

framework of ethical standards laid down by her Accountancy Institute. Mrs Townsley's detailed comments, which were appended to the NIAO Report, fall far short of an adequate explanation for what was a disgraceful conflict of public and private interests. Where there is a perception of serious conflicts, it is not sufficient to declare them, they must be effectively dealt with or avoided altogether. Moreover, the timing and pricing of Mr Townsley's share purchase is profoundly disturbing and amounts to 'insider trading'. The Department has referred these matters to the Department of Finance and Personnel to consider what action would be appropriate. We thought it extraordinary that a view had not already been taken on this. In view of the serious nature of the issues involved we are sending a copy of our report to the Institute of Chartered Accountants in Ireland.

6. **Departments have a duty to make certain that individuals appointed or re-appointed to Boards can demonstrate that they meet the probity principle,**[4] that is, that they are committed to the principles and values of public service and perform their duties with integrity. Departments must have a rigorous process to ensure that candidates for appointments to the Boards of public bodies meet the high standards expected of them.

7. **It is unsatisfactory that files relating to Mrs Townsley's appointments to LEDU were destroyed while she was still active in public life.** This case illustrates the importance of retaining these files well beyond the term of appointment. The Department of Finance and Personnel should take the lead in reviewing the retention policy in relation to appointment papers.

8. **Departments must also regularly assess the performance of Board or Audit Committee Members and put in place procedures which enable their prompt removal where there is, for example:**

- a lack of competence;
- failure to observe the probity principle; or
- an unmanageable conflict of interest.

It is also important that departments share information in a joined-up way to ensure that where there are concerns about the performance or probity of any Board Member this is taken into account in relation to any other public positions which they hold or may apply for.

9. **The Department should make compliance with the Code of Practice, issued by the Commissioner for Public Appointments for Northern Ireland, a condition of funding of third party organisations.** The Department told the C&AG that Northern Ireland departments are required to follow the guidance issued by the Office of the Commissioner for Public Appointments for Northern Ireland. This guidance extends to Executive NDPBs, Health and Personal Social Services Bodies and, by agreement, to advisory bodies and tribunals but does not apply to third party

4 Probity is one of the principles underlying the Code of Practice of the Commission for Public Appointments for Northern Ireland. The Code was first produced in 1996 and revised in 2002, 2004 and 2005.

organisations, such as EBT, which are entirely publicly funded. We are sending a copy of our report to the Commissioner for Public Appointments for Northern Ireland.

10. **There are some conflicts of interest that cannot be managed; they can only be dealt with by being avoided altogether.** Avoiding unmanageable conflicts not only provides reassurance to the public that decisions taken in public bodies are entirely based on what is in the public interest but protects individuals from any suspicion of bias. Public money should not be committed to any project where an unmanageable conflict of interest exists. For example, when investing in loan or venture funds, Departments and NDPBs should ensure that it is a requirement of funding that consultants acting as managers of the funds should not hold shares or directorships in companies supported by the funds. There should also be a bar on managers undertaking any consultancy work or providing financial services in client companies. These points should have been self-evident; it is disappointing that it is necessary to spell out these details for the Department of Enterprise, Trade and Investment.

11. **We recognise the valuable voluntary contribution Board Members make to public life in Northern Ireland but their reputations, as well as the public interest, need to be protected through effective training in their public responsibilities.** It is deeply disappointing that, in this case, LEDU did not provide guidance or training to EBT Board Members on conflicts of interest. The Department must take responsibility for ensuring that their own staff, Board Members of NDPBs and third party organisations understand the high ethical standards to which they are required to operate through guidance, education and training, particularly induction training. For Board Members this should include training on their role and responsibilities, including the level of engagement required and the need to exercise a challenge function. Moreover, we want to make it absolutely clear that public bodies have an obligation to safeguard the position of those appointed to public office by ensuring that proper controls and procedures are in place.

12. **The Department did not exercise an appropriate level of control over the NDPBs for which it was responsible and did not ensure effective oversight of third party organisations funded by its NDPBs.** Three venture funds which received financial support from the Department and its NDPBs were investing in a single company, raising the concern that there may be overlap and duplication of business activities among its other third party organisations. The Accounting Officer's decision to personally approve the setting-up of any new third party organisations by any of the NDPBs for which he is responsible, is a welcome move. The Department of Finance and Personnel should ensure that all Northern Ireland departments follow suit. The Department should provide an assurance that each third party organisation meets a specific and continuing need, there is no wasteful duplication of effort and that the audit arrangements are robust.

13. **It is worrying that the blatant conflicts of interest and other major control weaknesses in this case were not detected by the auditors of LEDU (Deloitte and Touche) or EBT (McClure Watters).** It is important that these matters are brought

to the attention of the relevant professional body and this Committee informed of the outcome.

14. **It emerged in evidence that the unsatisfactory way in which EBT was established was somehow related to the fact that the project was initiated by the International Fund for Ireland and only partly funded by LEDU.** The Committee want to make it absolutely clear that when a public body is involved in jointly funding a project, the fact that the funding is shared, in no way diminishes the Accounting Officer's absolute responsibility to ensure regularity, propriety and value for money.

15. **The Committee was astonished at the award of a three year rolling contract to MTF for the consulting services it provided to EBT.** The use of rolling contracts for consultancy services in the public sector or publicly funded bodies is most unlikely to deliver value for money. The Department of Finance and Personnel should issue guidance on this.

16. **EBT was engaged in high risk loan and share activities. There was no private sector money involved in this project to share the financial risks, yet it was structured as a limited company and placed outside the annual scrutiny of Parliament's auditors.** We welcome the fact that legislation is in hand to provide for the C&AG to audit companies. In our view, it would be an important safeguard against the control failures we have seen if such companies were audited by the C&AG.

17. **We found it surprising that the possibility of civil proceedings in relation to the fast-track Arcom loan, and other matters, including the payment of fees for managing loans which had already been written-off, had not been considered.** The Department needs to ensure that this is addressed. We noted that the fast track loan was guaranteed by the Department of Trade and Industry's scheme. We would like to be informed whether all the relevant facts, including conflicts of interest were disclosed to the Department of Trade and Industry.

18. **A clear message needs to be sent to senior public officials that any disregard for the proper conduct of public business is a serious disciplinary offence and will not be tolerated.** The Department should provide details of the disciplinary action taken in the EBT case and inform the Committee of the outcome when the case is concluded.

19. **The Department has taken a long time to deal with EBT and the other investigations. It is important that the three ongoing investigations are brought to a conclusion as soon as possible so that lessons can be learnt and applied throughout departments. The Committee do not wish to be in this situation ever again.** The Department should provide a report of the outcome of each investigation as it is concluded together with the findings of the Liquidator's report into EBT. In order to be satisfied that incomplete investigations are being expedited, the Committee want to see a progress report in six months.

1 Conflicts of interest in the establishment of Emerging Business Trust

1. The C&AG's Report into the Department of Enterprise Trade and Investment's oversight of its Local Enterprise Development Unit's (LEDU's) funding of Emerging Business Trust (EBT) has highlighted one of the worst failures of governance this Committee has seen. There were massive conflicts of interest in the combination of roles undertaken by Mrs Townsley, the Deputy Chair of LEDU. She was not only on the LEDU Board, one of the bodies funding EBT, but was also an EBT Board Member and her company, MTF, was appointed, through a flawed tendering process, to manage EBT. These appointments were made with the full knowledge of LEDU and the Department. This Committee's seminal report on 'The Proper Conduct of Public Business' (Eighth Report of 1993–94) states that "care should be taken to avoid actual, potential, perceived or perceivable conflicts of interest when employing consultants and staff."[5]

2. The Department attributed many of the problems found in this case to a "lack of insight" on the part of officials rather than a conscious decision not to do the right thing. However, insight is not a pre-condition for proper conduct; what is required is honesty and the commonsense observance of rules. In any event, this is not a convincing argument. Not only were the abuses in this case unusually blatant but LEDU's decision to challenge the appointment, on the grounds of conflict of interest, of a subsidiary provider of management services to the EBT Board, but not the appointment of Mrs Townsley, demonstrates that senior LEDU officials had sufficient insight and knowledge of the rules to take action. No explanation has been provided as to why these rules were not applied to Mrs Townsley. The Department has told us that the investigation found no evidence of collusion, but collusion is always difficult to prove and it cannot be ruled out in circumstances where no other credible explanation has been provided. We can only conclude that it was not an oversight that the decision taken favoured LEDU's Deputy Chair.[6]

3. Appointments to the boards of public bodies after 1996 should have observed the Code of Practice of the Office of the Commissioner for Public Appointments. The Code requires consideration of any apparent conflicts of interest. The Department was unable to confirm the extent to which this was done in any of Mrs Townsley's appointments prior to her being made a member of the Invest Northern Ireland Board in 2002, although she had been a member of the LEDU Board since 1993 and was re-appointed in 1996 and 1999. Even in 2002, the Department's appointment process failed to bring to light the conflicts in this case. At the request of Invest Northern Ireland, Mrs Townsley absented herself on a voluntary basis from its Board in December 2003 although she remained a Board Member until March 2004. This is an indication that voluntary arrangements for removing Board Members are not sufficiently robust.[7]

5 C&AG's Report, paras 10, 12; Qq 3, 9–13

6 C&AG's Report, paras 11, 1.21, 1.46; Qq 7–8, 78–80

7 C&AG's Report, para 17 and Appendix 4; Qq 13, 83–85

4. It is most worrying that the Department missed opportunity after opportunity to address one of the worst cases of conflicts of interest this Committee has seen. It is disappointing that files relating to Mrs Townsley's appointment to LEDU's Board have been destroyed.[8]

5. With hindsight the Department has correctly concluded that the potential conflicts of interest were so numerous and so fundamental in this case, they were beyond management. What beggars belief is that, at the time, there was little or no attempt to manage them. For example, LEDU gave no guidance to EBT on how to handle conflicts of interest between its managers and its client companies. What is worse, the Committee is left with the impression that the very senior staff in LEDU and the Department, who had knowledge of EBT, did not have sufficient regard for the proper conduct of public business to ensure effective oversight.[9]

8 C&AG's Report, para 1.1, footnote 9; Qq 13, 83, 94–97

9 C&AG's Report, paras 1.44–1.46; Qq 9–12, 62–63

2 Conflicts of interest in the operation of EBT

6. The extent of conflicts of interest in this case is shocking. EBT assisted a number of companies which had a pre-existing relationship with Mrs Townsley's accountancy practice. Mrs Townsley's husband owned shares in two (Arcom and Fusion) of the ten companies supported by the EBT Venture Fund. In both instances Mr Townsley's interests were acquired between the date the EBT investment was approved and the date the investment was completed.[10]

7. The role of the Townsleys' company, MTF, was to provide independent and objective financial advice to the EBT Board. It is clear that, in the case of Arcom, Fusion and a number of other EBT clients, the capacity of MTF to provide independent and objective advice was fundamentally compromised because of conflicts of interest.[11]

8. The evidence session focussed on clarifying the relationships between Mr and Mrs Townsley and Arcom. These are set out in the timeline at Figure 1. MTF had a business relationship with Arcom dating back to 1995. In August 1999 Mr Townsley was offered a 10% share in Arcom, an offer he asked to be put on hold. Two months later Arcom applied for an EBT loan. Mrs Townsley appraised the loan application. The Loan Fund approved a £20,000 loan in November 1999.[12]

10 C&AG's Report, para 2.6; Qq 54–57, 131–134

11 C&AG's Report, paras 2.21, 2.23; Qq 32, 138–141

12 C&AG's Report, para 2.7; Qq 131–134

Figure 1: The relationship between Arcom and EBT

Date	Event
1995 to 1998	Mr and Mrs Townsley's firm, MTF, acts at various times as consultants and accountants to Arcom.
August 1999	Mr Townsley is offered 10% share in Arcom – he asks for the offer to be put on hold.
October 1999	Arcom applies to EBT Loan Fund. Its application was appraised by Mrs Townsley.
November 1999	EBT Loan Fund approves a £20,000 loan to Arcom.
April 2000	EBT Venture Fund Board approves, in principle, an equity investment in Arcom.
September 2000	MTF and its subsidiary, Disorder Digital Media, carry out consultancy work for Arcom.
November 2000	Mr Townsley is appointed a director of Arcom and purchases 10% share in Arcom for £2,500 (£1.08 a share).
December 2000	EBT Venture Fund agrees to purchase 10% of Arcom for £50,000 (£19.49 a share) plus £20,000 of preference shares.
December 2002	Mrs Townsley recommended to the Board an additional £25,000 loan under the Department of Trade and Industry's Small Firms Loan Guarantee Scheme (SFLGS).
February 2003	SFLGS loan of £25,000 is paid.
September 2003	Arcom Liquidator is appointed.

Source: C&AG's Report, Appendix 1

9. EBT's Venture Fund approved, in principle, an equity investment in Arcom in April 2000. In November 2000, Mr Townsley was appointed to the Board of Arcom and purchased 10% of shares for £2,500, each share costing £1.08. Less than three weeks later, EBT Venture Fund purchased £20,000 of preference shares and 10% of ordinary shares for £50,000, each share costing £19.49. In our view Mr Townsley's actions amount to 'insider trading'. During this period Arcom also had a business relationship with a company called Digital Disorder Media, a subsidiary of MTF Technology Limited of which the Townsleys were shareholders and Directors.[13]

10. In December 2002, Mrs Townsley recommended to the EBT Board an additional fast track loan of £25,000 to Arcom, although the company's draft financial statements and management accounts showed that it was in financial difficulties. The loan was made in February 2003. Arcom went into liquidation in September 2003 with a potential loss to EBT of £100,000. The possibility of civil proceedings in relation to the quality of MTF advice on the fast track Arcom loan had not been considered.[14]

13 C&AG's Report, paras 2.8–2.11; Qq 54–57, 64–74, 135–141

14 C&AG's Report, para 2.10; Qq 139–141, 152–154

11. Mrs Townsley acted as Company Secretary for both the EBT Loan Fund and the EBT Venture Fund from their establishment. 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. In this case the Accounting Officer told us that the Board would have looked to the Company Secretary to provide advice on conflicts of interest. It is obviously unsatisfactory that the person charged with advising on conflicts of interest was the main source of the conflicts.[15]

12. A Liquidator has been appointed to examine the circumstances in which EBT went into voluntary liquidation in 2005. This will include consideration of the performance and conduct of the Directors, including Mrs Townsley. Directors of insolvent companies may be disqualified, for between 2 and 15 years, if there has been 'unfit conduct' such as negligence, incompetence or lack of commercial integrity.[16]

13. Mrs Townsley had considerable experience of the public sector. She was on the Boards of the Health and Safety Executive, LEDU and Invest Northern Ireland. She was also on the Department's Audit Committee, Chair of the LEDU Audit Committee and the Health and Safety Executive Audit Committee and a Member of the Senate and Honorary Treasurer of Queen's University Belfast. These are all appointments where a commitment to the principles and values of public service, as described by Lord Nolan, and an understanding of conflicts of interest are vital. The Department has concluded that there is no basis for criminal charges in this case. However, there are questions about whether behaviour was ethical. Mrs Townsley is a member of the Institute of Chartered Accountants in Ireland. All accounting institutes require their members to operate within a framework of ethical standards. The Department has asked the Department of Finance and Personnel to consider what action would be appropriate.[17]

14. The Accounting Officer has written to the Committee explaining that Mrs Townsley no longer holds any public appointments. We note that at the time of our evidence session on 13 February 2006 she was Honorary Treasurer of the Queens University of Belfast. However, she resigned from this position on 22 February 2006.[18]

15 C&AG's Report, para 2.3; Q 32

16 C&AG's Report, para 1.45; Qq 20, 153

17 C&AG's Report, paras 11, 1.14, 1.43, 4.15; Qq 13, 59–61

18 Ev 15

3 Failings in LEDU's oversight of EBT

15. We commend Invest Northern Ireland, which replaced LEDU in April 2002, for promptly identifying and investigating the failings in this case.[19]

16. In 1996 the International Fund invited four organisations, including an accountancy practice, MTF, in which the Deputy Chair of LEDU was a partner, and LEDU itself, to tender for the establishment of EBT. It is not clear on what basis these four organisations were selected or why an open competition was not held. Without an open competition the Department is unable to demonstrate that the award of such a valuable contract to MTF represented value for money. It is appalling that the well established rules for procurement of services involving public money were set aside. The terms of the contract were heavily loaded in favour of MTF; it is unacceptable that the contract was awarded on a three year rolling basis and was never tendered again, although it was renewed in 1999 and 2000.[20]

17. The Accounting Officer acknowledged that LEDU should have objected at the outset to that particular form of contract. Given that the Department also knew about the terms on which MTF was appointed to manage EBT, it too should have objected at the outset to the terms of the appointment of MTF.[21]

18. There was no signed contract between MTF and EBT. When the International Fund for Ireland issued its Letter of Offer in 1996 it appended a draft contract that was never signed by the parties concerned, though it did form the basis of the working relationship between the parties. However, it is clear that the unsigned contract was not sufficiently robust or comprehensive to support a business relationship worth £1.4 million. This led to the Board making a number of payments to MTF which it later argued were not covered by the unsigned contract. The Accounting Officer surmised that the contract was prepared by the International Fund staff but could not be sure. Whoever was responsible, the document was clearly defective and, setting aside the conflicts of interest, the Department should have insisted on sound contractual arrangements.[22]

19. Mrs Townsley's accountancy practice received a total of £1.4 million in management fees out of the £4.35 million in public funds paid to EBT. This represents over a quarter of the total funding made available for small business regeneration. The C&AG found that the management of loan fund bad debts was poor. The Loan Fund paid MTF £77,000 in fees which could have been avoided if the loans had been written-off on a timelier basis.[23]

20. On an occasion when a LEDU Grant Inspector, challenged the information provided by EBT, his concerns were dismissed by Mrs Townsley. It was fundamentally unsound to expect a relatively junior official, in the course of his duties, to challenge the LEDU Board member who was managing a project LEDU had funded. It was precisely to avoid this kind

19 C&AG's Report, paras 7, 9; Qq 22, 121

20 C&AG's Report, paras 1.3, 1.32, 1.47; Qq 31, 36–50

21 C&AG's Report, para 1.32; Qq 47–48

22 C&AG's Report, paras 1.40, 3.12 and Appendix 6; Qq 114–118

23 C&AG's Report, paras 319–3.20, 3.23 and Table 4.1; Qq 147–150

of problem that this Committee in a 1996 Report[24] into another of the Department's NDPBs made it clear that "*it can never be acceptable for a Board Member to negotiate directly with Board officials for grant assistance.*"[25]

21. The fast-track loan to Arcom was provided under the Department of Trade and Industry's Small Firm Loan Guarantee Scheme. EBT, as a qualified lender within the scheme, was guaranteed 85% of the value of the loan by the Department of Trade and Industry in the event of a default. The loan was provided in this way because of the risks of the sector and the company and because no security was offered by Arcom. The Department did not know whether EBT satisfied its obligation to provide the Department of Trade and Industry with all the necessary information on the loan proposal. The impression is that EBT was trying to safeguard its prior investment by offloading a particularly risky loan to the Department of Trade and Industry and disregarding the fact that this was also public money.[26]

22. The senior official who was LEDU's representative on the EBT Board should have been well placed to guide the Board on governance and financial control issues. Despite the guidance produced by this Committee on the role of nominee directors,[27] he failed in his duty to point out elementary good practice, and seems to have been oblivious to the innumerable problems in this case including the failure to observe competitive tendering rules. He failed to bring any questionable practices to the attention of the funding bodies. In the Committee's view, he must have been fast asleep.[28]

23. This official is on precautionary suspension with pay in relation to his involvement with one of the three other bodies currently under investigation. Invest Northern Ireland told us that it will wait until the investigation of this case is complete before any further action is taken and the cumulative effect is understood. A second official, the former head of the Business Development Division of LEDU, has been formally disciplined as a result of the EBT case.[29]

24. The C&AG's Report shows that LEDU's operating procedures did not permit capital grants or equity to be paid through a third party organisation. However, to facilitate the establishment of EBT's Venture Fund, LEDU proposed to employ an indirect payment mechanism which was intended to circumvent this restriction. The Committee agrees that this type of creative funding is wholly improper in a public body. This was, however, only one in an extraordinary series of lapses identified in the C&AG's Report. For example, there was no independent appraisal of the business case to establish the Loan Fund; LEDU failed to establish distinct Boards for the Loan and Venture Funds in contravention of the independent consultant's advice; LEDU failed to disclose Mrs Townsley role in EBT in its own accounts which were audited by Deloitte and Touche; and it did not secure all the

24 11th Report from the Committee of Public Accounts, *Selective financial assistance for tourism in Northern Ireland* (HC 266, Session 1995–96)

25 C&AG's Report, para 4.23 and Appendix 3; Q 3

26 C&AG's Report, para 2.10; Q 75

27 1st Report from the Committee of Public Accounts, *Role and responsibilities of Nominee Directors* (HC 33, Session 1985–86 (incorporating HC 124-i (1984–85))

28 C&AG's Report, paras 4.18–4.19; Qq 5–9, 75, 111

29 Qq 119–120, 127–130

necessary approvals from the Department and the Department of Finance and Personnel before committing funds to EBT. LEDU issued ineffective Letters of Offer which failed to protect public funds, for example, LEDU's Letters of Offer were completely silent on how conflicts of interest involving EBT managers should be handled.[30]

25. The problems in LEDU date back to 1995, yet in 2006 many of these have not been resolved. Although the EBT investigation started in 2003, the case is ongoing. Investigations are also underway into contracts with three other third party organisations inherited by Invest Northern Ireland, where there are points in common with EBT and concerns about the proper use of public funds. Two of these cases, where Mrs Townsley has a connection to the bodies concerned, have been referred to the Inspectors appointed under Northern Ireland companies' legislation. The third has been referred to the Police Service of Northern Ireland.[31]

30 C&AG's Report, paras 1.47, 4.17; Qq 31, 63

31 C&AG's Report, para 11 and Appendix 3; Qq 15–16, 22–25

4 Failings in the Department's oversight of LEDU and its other NDPBs

26. The Department has accepted responsibility and quite properly apologised for the very significant failings in its oversight of LEDU. It identified that the key problem was the relationship between the Department and LEDU which was "insufficiently hands-on and insufficiently interrogative." The Committee, however, is not convinced that an inadequate structural framework is the main cause of the problems between the Department and LEDU. The Accounting Officer stated that there were a range of controls and procedures in place at the material time. However, the telling point for the Committee is the Accounting Officer's acceptance that these procedures were not applied. Crucially, individuals within the Department and LEDU chose not to follow the rules.[32]

27. It is extraordinary and very disturbing that the Department did not know at the time that three of the venture funds it supported, Viridian Growth Fund, Nitech Growth Fund and EBT, were bankrolling a company (Fusion) of which Mr Townsley was a co-founder, Finance Director and major shareholder. It seems that the Department and its NDPB were not communicating with each other. This case may be symptomatic of a wider problem in the Department's funding of third party organisations. Invest Northern Ireland inherited 40 third party organisations from LEDU alone and there must remain a concern that there may be overlap and duplication of business activities, not just in the venture funds but between other entities.[33]

28. LEDU's auditors did not detect or report on the poor control over EBT and other third party organisations, such as the extent of conflicts of interest and that rules on competitive tendering were not being observed. Similar deficiencies were also evident in the statutory audit of EBT, for example, auditors failed to identify that EBT was acting 'ultra vires' in awarding loans and equity funding above the maximum permitted in LEDU's Letters of Offer. They also failed to pick up the absence of a fully functioning bad debt policy; that management fees could have been reduced when debts were written-off, and that there was no signed contract with MTF. The Accounting Officer suggested that the auditors of EBT may have regarded their duty as being to the company and not to the funding bodies. If this is the case, it is clearly an unsatisfactory arrangement when EBT was totally dependent on public money.[34]

29. The Accounting Officer estimates that, of the £4.35 million of public funds paid by the International Fund for Ireland and LEDU to EBT, £1.9 million will be recovered through the Liquidator. LEDU's contribution was £0.95 million, of which £0.5 million came from the EU Peace and Reconciliation Programme.[35]

32 C&AG's Report, para 1.42; Qq 17, 26

33 C&AG's Report, paras 7, 2.15; Qq 76–77

34 C&AG's Report, paras 1.47, 3.23, 3.26, 4.9–4.10; Qq 100–110

35 C&AG's Report, para 17 and Table 4.1; Q 151

30. The Department seems to have been complicit in an explosion of small publicly funded companies in the 1990s. LEDU alone was responsible for 40 third party organisations, many of which, including EBT, were entirely publicly funded. This framework placed the taxpayers' money entrusted to these companies outside the audit of the NIAO and therefore, at a distance from the scrutiny of Parliament. This structural fault created the conditions for some of the extraordinary lapses in this case. The Department has told us that it was a condition of funding of the European Peace and Reconciliation Programme that funds were disbursed by third party organisations in order to reach out to the Northern Ireland community, particularly in disadvantaged areas. A similar policy was adopted by the International Fund for Ireland. This is not a completely convincing explanation. The suspicion remains that some of these elaborate structures were a mechanism to circumvent proper financial management and public accountability.[36]

31. The Department has been responsible for a long litany of serious failures of control from its supervision of the Northern Ireland Tourist Board, to 'Into the West' and now EBT. It simply cannot afford any more failures like this. The Committee welcomes therefore the measures taken by the Department, set out at paragraph 17 of the C&AG's Report, which record the action taken so far to remedy the deficiencies highlighted in this case. We were particularly impressed that the new Accounting Officer, Mr Stephen Quinn, has now introduced quarterly rather than annual Statements of Internal Control from NDPB Chief Executives and senior officers in the Department which he emphasised require a positive act of due diligence before they are signed. We agree that it is not enough for such controls and procedures to be in place, they must be applied. As the Accounting Officer explained, "it's not just what you do; it's the way that you do it". This is a promising response to the challenge the Department faces.[37]

36 C&AG's Report, para 7; Qq 29–30, 98–99

37 C&AG's Report, para 17; Qq 28, 143

Formal minutes

Wednesday 10 May 2006

Members present:

Mr Edward Leigh, in the Chair

Annette Brooke	Sarah McCarthy-Fry
Greg Clark	Mr Austin Mitchell
Mr Ian Davidson	Mr Alan Williams
Helen Goodman	

A draft Report (Governance issues in the Department of Enterprise, Trade and Investment's former Local Enterprise Development Unit), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 31 read and agreed to.

Summary read and agreed to.

Conclusions and recommendations read and agreed to.

Resolved, That the Report be the Forty-sixth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Monday 22 May at 4.30 pm.

Witnesses

List of written evidence

List of Reports from the Committee of Public Accounts Session 2005–06

First Report	Managing National Lottery Distribution Fund balances	HC 408 *(Cm 6712)*
Second Report	The regeneration of the Millennium Dome and associated land	HC 409 *(Cm 6689)*
Third Report	Ministry of Defence: Major Projects Report 2004	HC 410 *(Cm 6712)*
Fourth Report	Fraud and error in benefit expenditure	HC 411 *(Cm 6728)*
Fifth Report	Inland Revenue: Tax Credits and deleted tax cases	HC 412 *(Cm 6689)*
Sixth Report	Department of Trade and Industry: Renewable energy	HC 413 *(Cm 6689)*
Seventh Report	The use of operating theatres in the Northern Ireland Health and Personal Social Services	HC 414 *(Cm 6699)*
Eighth Report	Navan Centre	HC 415 *(Cm 6699)*
Ninth Report	Foot and Mouth Disease: applying the lessons	HC 563 *(Cm 6728)*
Tenth Report	Jobskills	HC 564 *(Cm 6724)*
Eleventh Report	Local Management of Schools	HC 565 *(Cm 6724)*
Twelfth Report	Helping those in financial hardship: the running of the Social Fund	HC 601 *(Cm 6728)*
Thirteenth Report	The Office of the Deputy Prime Minister: Tackling homelessness	HC 653 *(Cm 6743)*
Fourteenth Report	Energywatch and Postwatch	HC 654 *(Cm 6743)*
Fifteenth Report	HM Customs and Excise Standard Report 2003–04	HC 695 *(Cm 6743)*
Sixteenth Report	Home Office: Reducing vehicle crime	HC 696 *(Cm 6743)*
Seventeenth Report	Achieving value for money in the delivery of public services	HC 742 *(Cm 6743)*
First Special Report	The BBC's investment in Freeview: The response of the BBC Governors to the Committee's Third Report of Session 2004–05	HC 750 *(N/A)*
Eighteenth Report	Department for Education and Skills: Improving school attendance in England	HC 789 *(Cm 6766)*
Nineteenth Report	Department of Health: Tackling cancer: improving the patient journey	HC 790 *(Cm 6766)*
Twentieth Report	The NHS Cancer Plan: a progress report	HC 791 *(Cm 6766)*
Twenty-first Report	Skills for Life: Improving adult literacy and numeracy	HC 792 *(Cm 6766)*
Twenty-second Report	Maintaining and improving Britain’s railway stations	HC 535 *(Cm 6775)*
Twenty-third Report	Filing of income tax self assessment returns	HC 681 *(Cm 6775)*
Twenty-fourth Report	The BBC’s White City 2 development	HC 652
Twenty-fifth Report	Securing strategic leadership in the learning and skills sector	HC 602 *(Cm 6775)*
Twenty-sixth Report	Assessing and reporting military readiness	HC 667 *(Cm 6775)*
Twenty-seventh Report	Lost in translation? Responding to the challenges of European law	HC 590 *(Cm 6775)*
Twenty-eighth Report	Extending access to learning through technology: Ufi and the learndirect service	HC 706 *(Cm 6775)*
Twenty-ninth Report	Excess Votes 2004–05	HC 916 *(N/A)*

Thirtieth Report	Excess Votes (Northern Ireland) 2004–05	HC 917 *(N/A)*
Thirty-first Report	Northern Ireland’s Waste Management Strategy	HC 741
Thirty-second Report	Working with the voluntary sector	HC 717
Thirty-third Report	The Royal Parks and the Diana, Princess of Wales Memorial Fountain	HC 644
Thirty-fourth Report	Returning failed asylum applicants	HC 620
Thirty-fifth Report	The refinancing of the Norfolk and Norwich PFI Hospital	HC 694
Thirty-sixth Report	Tackling the complexity of the benefits system	HC 765
Thirty-seventh Report	Inland Revenue Standard Report: New Tax Credits	HC 782
Thirty-eighth Report	Channel Tunnel Rail Link	HC 727
Thirty-ninth Report	Consular services to British nationals	HC 813
Fortieth Report	Environment Agency: Efficiency in water resource management	HC 749
Forty-first Report	The South Eastern Passenger Rail Franchise	HC 770
Forty-second Report	Enforcing competition in markets	HC 841
Forth-third Report	Delivery chain analysis for bus services in England	HC 851
Forty-fourth Report	National Offender Management Service: dealing with increased numbers in custody	HC 788
Forty-fifth Report	Employers' perspectives on improving skills for employment	HC 862
Forty-sixth Report	Governance issues in the Department of Enterprise, Trade and Investment’s former Local Enterprise Development Unit	HC 918

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Monday 13 February 2006

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr David Curry
Jon Trickett
Kitty Ussher
Mr Alan Williams

Mr J M Dowdall CB, Comptroller and Auditor General, Northern Ireland Audit Office, was in attendance and gave oral evidence.

Mr David Thomson, Northern Ireland Treasury Officer of Accounts, was in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Standard Report 2005–06 (HC 817)

Witnesses: **Mr Stephen Quinn,** Permanent Secretary; **Mr Noel Lavery,** Finance Director, Department of Enterprise, Trade and Investment; **Mr Leslie Morrison,** Chief Executive and Accounting Officer, and **Mr Charles Harding,** Head of Corporate Finance Appraisal and Advisory Division, Invest Northern Ireland; gave evidence.

Q1 Chairman: Good afternoon. Welcome to the Committee of Public Accounts. Whilst Stormont is suspended we are the Committee of Public Accounts for Northern Ireland—something we regret but that is beyond our control and therefore we have to do our job—and today we are considering the C&AG's Report on Governance issues in the Department of Enterprise, Trade and Investment's former Local Enterprise Development Unit, published on 9 February 2006, and we welcome back Mr Stephen Quinn, who is the new Permanent Secretary for the Department of Enterprise, Trade and Investment in Northern Ireland. And you have been in post six weeks?
Mr Quinn: That is right.

Q2 Chairman: Could you start by introducing your colleagues and explain to us their responsibilities?
Mr Quinn: Thank you. On my immediate right is Leslie Morrison, the Chief Executive of Invest Northern Ireland, which is the successor body to LEDU, that is to say it absorbed the former functions of LEDU along with the former functions of the Industrial Development Board and another body. On his immediate right is Charles Harding, who is the assistant secretary or grade five in charge of the corporate finance appraisal division in Invest Northern Ireland, and on my left is Noel Lavery, the finance director of the department.

Q3 Chairman: Thank you. Perhaps we could start by looking at paragraph 10 of the Comptroller and Auditor General's Report which is, I suppose, a useful summary of the main findings of the investigations. I have to say that when my colleagues and myself looked at this we came to the initial conclusion that this was one of the most worrying failures of governance that we have come across in our time on this Committee, and clearly there appears on the face of it to have been a real conflict of interest. What we see here is that LEDU funded a project which apparently benefited its own deputy chairman, in the process it broke its own rules, ignored good practice, failed to question anything that was going wrong—so am I right, and what are your conclusions?
Mr Quinn: Yes, you are right in the sense that paragraph 10 is a fair and accurate summary of the key facts in this Report and represents a very serious failure in the standards of governance and the standards of administration within LEDU. I think I need to go on to say it reflects a shortcoming in the oversight of LEDU by the Department during the material period. Paragraph 17 of the Report actually acknowledges that, in December 2002, the Department in its reply to the Assembly PAC acknowledged the systemic difficulties it had in the oversight of its NDPBs during the 1990s, and I think that this Report effectively reinforces and validates that conclusion.

Q4 Chairman: Why did you allow it to happen?
Mr Quinn: I think that the explanation is the explanation offered to the Assembly PAC in December 2002, namely that the business model that the Department operated with its NDPBs left them too much at arm's length with too much latitude and not enough oversight, and that was the essence of the acknowledgement that the Department gave to the Stormont PAC in December 2002. That relative arm's length relationship led to insufficient care undertaken in checking—

Q5 Chairman: I must interrupt you there. You say it was arm's length. Would you like to look at paragraph 1.7 of the Report, which shows that your representative on the EBT board is LEDU's Director of Corporate Services and Acting Chief Executive, so you would have thought he would be an ideal person to keep this show on track and would be an ideal person to know what was best practice, and he was LEDU's Director of Corporate Services. It does not sound very arm's length to me.
Mr Quinn: Well, he was the director of corporate services in LEDU which was at arm's length from the Department. I agree with you that he should have been well placed to guide the EBT board on governance and financial control issues, and to look after the interests of the funding body—

Q6 Chairman: But did he warn anybody of the potential conflicts of interest?
Mr Quinn: There is no evidence that he did.

Q7 Chairman: Why did he not?
Mr Quinn: Well, it does seem to me that there must have been a lack of insight there.

Q8 Chairman: Well, he must have been fast asleep!
Mr Quinn: That is one way of putting it. As I say, as a minimum there appears to have been lack of insight. There were clear signs, there were things that were visible to him from his position on the board of EBT that should have prompted him to intervene on behalf of the funding body.

Q9 Chairman: Well, I think if you have an official on one of these boards it is his duty to point out elementary good practice. Have you seen the Committee of Public Accounts' 8th Report of 1993–94, which although before my time apparently is a seminal Report, although it is not before the time of Mr Alan Williams, on the Proper Conduct of Public Business. Have you read it?
Mr Quinn: I have indeed.

Q10 Chairman: I am told it is widely circulated in government departments. It says here: "Checklist. Care should be taken to avoid actual or potential perceived or perceivable conflicts of interest when employing consultants and staff". So what happened to this Report, then?
Mr Quinn: Well, it was circulated, Chairman, but I think I would have to acknowledge that its findings were not fully and comprehensively—

Q11 Chairman: Did it make any impact on your Department at all?
Mr Quinn: Well, I think it did. I was going on to say that it was not comprehensively and fully applied in all respects, and I think that is particularly the case in respect of the—

Q12 Chairman: What do you mean, it was not "comprehensively applied"? It was not applied at all, was it?
Mr Quinn: There were certainly very significant failings in the oversight of LEDU.

Q13 Chairman: Would you please look at paragraph 1.1 of the Report? We read there that Mrs Townsley was a board member from 1993 to 2004, and you reappointed or your predecessor reappointed her to the board on three further occasions, appointed her a member of the Departmental Audit Committee, so there were many opportunities to keep a track of what was going on. Why did nobody spot this earlier on?
Mr Quinn: Chairman, could I distinguish between two things? One is the state of knowledge of the Department in 1996 and, secondly, the various public appointments that Mrs Townsley had? The Department did have a degree of knowledge of the establishment of EBT, of the proposal to establish EBT in 1996 through its representative on the body that provided advice and support to the International Fund for Ireland. It also had knowledge of the establishment of EBT through its representative on the LEDU board in August 1996, so I am afraid to say there was a degree of knowledge of the proposal to establish EBT, its structure and the intention to make MTF the provider of management services. That is regrettable. I think that the Department should have been more alert to the full range of conflicts of interest that those decisions gave rise to.

Q14 Chairman: So do you now want to apologise on behalf of the Department?
Mr Quinn: Yes. I think that would be appropriate.

Q15 Chairman: I would like to look at paragraph 11. Apparently you have said that Invest Northern Ireland is looking at three other bodies where there are points in common with EBT concerned about the proper use of public funds. Can you tell us anything about these?
Mr Quinn: Yes. I wrote to the Clerk on 1 February to acquaint him with developments not only in relation to those three cases but also in relation to the on-going consideration of the liquidation of the EBT.[1] Two of the three cases related to TPO relationships inherited by Invest Northern Ireland from the former LEDU. The third was a legacy from the Industrial Research and Technology Unit and the Industrial Development Board. In two cases, they are with the Companies Inspector for investigation, that is the present state of play. The third case was examined and then referred to the Police Service for Northern Ireland, and that investigation continues.

Q16 Chairman: Do any of these investigations involve Mrs Townsley, or not?
Mr Quinn: Well, I am not sure that the investigations involve her, Chairman. It is my understanding that she had a connection of sorts with two of the companies involved.

Q17 Kitty Ussher: Thank you very much. Why are we in this situation, Mr Quinn?

[1] Ev 13–14

Mr Quinn: Well, I think I would go back to the December 2002 memorandum of reply to the Assembly PAC. What it essentially said under fairly rigorous examination by the Assembly PAC was that there was an acknowledgement that the Department had too much of a hands-off relationship with the NDPBs during the 1990s. If you look at paragraph 17 of the Report you will see a long list of things that the Department and Invest Northern Ireland has done to take account of the fact that that relationship was insufficiently hands-on and insufficiently interrogative. I think that is the key.

Q18 Kitty Ussher: I do not like using the word "blame" but if we were to say whose fault it was that we are in this situation, do you accept that that lies entirely with the Department?
Mr Quinn: Well, insofar as the Department had a policy of having that kind of a relationship rather than a more hands-on relationship with LEDU then the answer to that must be yes, but I think there are issues raised by this Report which go beyond that particular problem.

Q19 Kitty Ussher: Could you elaborate slightly on that?
Mr Quinn: In terms of the internal governance of LEDU and of the conflict of interests beyond LEDU in EBT.

Q20 Kitty Ussher: Do you think Mrs Townsley behaved with all propriety in explaining the conflicts of interest that could potentially be there to all the officers around her?
Mr Quinn: Ms Ussher, I am very reluctant to comment on anybody's conduct for this reason: The liquidator is currently examining the circumstances in which the EBT loans fund and the EBT venture fund went into liquidation. That involves an examination of the performance and conduct of the directors, of whom Mrs Townsley was one, and I just would not want to say anything that would either prejudice the conduct of that investigation or consideration or, indeed, the natural justice rights of Mrs Townsley or anybody else.

Q21 Kitty Ussher: Okay, and I appreciate that you have written to the Clerk to explain that more clearly, and we have heard and accept your apology obviously. Next, you say that in your response to the Stormont PAC you acknowledge the problems that had arisen and that was in 2002, is that right?
Mr Quinn: That is right, but it related to events which, of course, pre dated that.

Q22 Kitty Ussher: Indeed, and here we are in 2006 and investigations are still on-going. Why has it taken so long?
Mr Quinn: Well, in terms of the EBT investigation, that came to the attention of Invest Northern Ireland very late in calendar year 2002 and they initiated a forensic investigation in January 2003. That investigation, and I am not the most expert witness on that particular investigation in the team today, took a long time for two reasons. One, it was extremely complex and, two, it involved extensive clearances with all of the corporate bodies and individuals involved.

Q23 Kitty Ussher: But there are other investigations that are still on-going? The liquidator is still looking into it, is this right, you have detailed in your letter to us. Why has this taken so long?
Mr Quinn: The reason is that the investigation into EBT began in January 2003; the board of EBT decided to go into voluntary liquidation in 2005. The liquidator has now started his examination.

Q24 Kitty Ussher: I understand. When do you think we will get closure on this issue?
Mr Quinn: I do not know, is the straight answer, because only the liquidator knows when he will bring that process to a conclusion.

Q25 Kitty Ussher: All right. It seems to have been dragging on a rather long time and the reason I ask those questions is that presumably there are lessons to be learned from the entire situation, and we do not wish to be in this situation again ever, so we need to bring everything to a conclusion in order to really understand what lessons need to be learned. But you say you have taken several actions already to make sure this will not happen again, and you are confident that they will work and that the whole atmosphere within which non departmental bodies and their relationships with the private sector and so on is entirely different, are you now?
Mr Quinn: We have been learning the lessons from the PwC investigation of EBT as we go along, and if you look at the relatively long list of things that have been done both specifically arising from the EBT investigation and more generally in respect of the governance and financial control systems and procedures you will see that we are learning as we go along. If you look at paragraph 17 we believe for the time being that we are doing everything we can to improve governance and financial control in the Department and its NDPBs but we are open-minded about the new things we can do. In fact, since the Report was cleared I have decided, for instance, that no new third party organisation will be created by the Department or by any of its NDPBs without my personal approval.

Q26 Kitty Ussher: That is helpful. What I am struggling to understand is why there was such a lack of control and a lack of awareness of these issues a few years ago. I understand they may well now be being corrected or be in the process of being corrected but in terms of management culture is it because of the devolution or lack thereof? Is it because these are new bodies? Is it to do with the political environment? Are there lessons that other Departments should be learning and translating across? What are your views on that?
Mr Quinn: I would refer you to paragraph 1.42 of the Report which sets out the range of controls and procedures that were in place at the material time. They were quite extensive and the Audit Office

acknowledged that. The other thing is paragraph 16 made the perfectly valid point that it is not just enough to have these procedures in place; you have to apply them effectively, and I think it was the second bit that fell down because 1.42 is quite a robust set of procedures. What was your second point?

Q27 Kitty Ussher: I want to know whether other departments in Northern Ireland should be learning from the failures of your own Department at this particular time? Why was there such a systemic failure and is this something you should be sharing? Are you on a learning curve that other departments should also be on?
Mr Quinn: Other departments are on it because we have kept them abreast of the development of this Report and the issues in it, and this has been circulated—not by us but by the Department for Finance and Personnel to all Northern Ireland government departments.

Q28 Kitty Ussher: And are they changing their procedures as a result?
Mr Quinn: I cannot speak for any other department but I take you back to paragraph 17 and I think it does represent not just an enhancement of the systems and procedures that are in place but it goes back to the old point, "It's not just what you do, it's the way that you do it", and for instance part of the spirit of paragraph 17 is much more challenging behaviour in the Audit Committees, both in the Department and in the NDPBs, and for instance I have put what were previously annual statements of internal control from chief executives on to a quarterly basis for 2006–07. I regard statements of internal control as requiring a positive act of due diligence by chief executives before they sign, and therefore I regard that as one of the ways to make sure that management checks are being done and that the thing is not just a simple formality.

Q29 Kitty Ussher: And it was a simple formality, was it, because of management failure at the top of your Department at that time which did not actually look at the effect of the policy that was on paper, ie that it was not being implemented in an effective way? Or is it a more general point about the maturity of the political institutions in Northern Ireland such that this is a kind of necessary step that people have to go through, do you think?
Mr Quinn: On the second point, first, if I may, I would make a slightly different point which is that during the 1990s there was a substantial amount of money available through the European Peace and Reconciliation Programme and through the International Fund for Ireland, both of which feature in this context, and both of those institutions or programmes had a positive policy of outreach and they wanted to disburse at least a proportion of their money through third party organisations. In fact, when the European Peace and Reconciliation Fund was being set up they insisted it was a condition of the programme to include disbursement by what we call the Intermediary Funding Bodies, and I think that had a bit of an effect. It had clearly the effect of lengthening the lines of communication and control and I think, as evidenced here, it weakened them.

Q30 Kitty Ussher: So are there lessons to be learned from the European Peace and Reconciliation Fund as well?
Mr Quinn: Well, I think the lesson is that if you were going to have more extended lines of communication and control, and if you were going to have an outreach that mobilises sources of expertise that you do not have, then you must pay particular attention to making sure that the appropriate governance and financial control procedures are in place.
Kitty Ussher: Very interesting. Thank you.

Q31 Jon Trickett: This is a disgraceful Report, by the way, but let us try to unpick one or two issues. In paragraph 1.47 there is what is described as an "extraordinary series of lapses", and I want to take you to the third one which relates to competitive tendering. Now MTF, which is the company which really gives raise to all the problems, has a contract for management services. Can you very briefly describe what those management services are, or were?
Mr Quinn: I cannot I am afraid. They are described somewhere in the Report. I think one of the problems is that the management contract which was attached to the IFI letter of offer in 1996 was insufficiently specific, and that is why, for instance, you have at appendix 5 or 6, which deals with additional payments to MTF for services which were deemed by the EBT board not to be in accordance with the original management contract. But I guess it is just a question of administration services to the board of the Emerging Business Trust.

Q32 Jon Trickett: Is it arguable that one of the services MTF might have provided was to advise the board about conflicts of interest?
Mr Quinn: Well, I think the board might have looked to the company secretary for that service.

Q33 Jon Trickett: The company secretary of MTF?
Mr Quinn: The company secretary of the EBT board.

Q34 Jon Trickett: I do not think I am very satisfied that we do not know what the services were precisely specified at the time the contract was let, but it says in a very curious form of words: "The competitive tendering public sector rules were not insisted upon". What does that mean? What went wrong?
Mr Quinn: Would you like Leslie Morrison?

Q35 Jon Trickett: Please, but please be reasonably brief.
Mr Morrison: Administrative services broadly included preparing casework, except in instances where there could be seen to have been a conflict in preparing casework, when others did that. But broadly it was not fund management as such, it was administrative and casework preparation.

Q36 Jon Trickett: But which competitive rules were not insisted upon at the time they were given what was a very valuable contract, at the end of the day?
Mr Quinn: The normal practice, and what would have been regarded as good practice, would have been an open and competitive tender—

Q37 Jon Trickett: How many companies were invited to tender when it was first let?
Mr Quinn: Four.

Q38 Jon Trickett: And on what basis were they selected?
Mr Quinn: That is not absolutely clear. It would appear that the International Fund drew up a short list.

Q39 Jon Trickett: And nobody is now aware as to why the particular four were placed upon it?
Mr Quinn: I cannot illuminate that point, no.

Q40 Jon Trickett: I think I remember somebody else saying it was impossible to demonstrate there was collusion at that stage but two of the tendering companies came together subsequently to form a single—
Mr Quinn: No. MTF won that competition among the four. One of the other competitors was LEDU which was the Department's NDPB, and the IFI asked for MTF and LEDU to coalesce in the formation of EBT, but the management contract went solely to MTF.

Q41 Jon Trickett: Because normally when we in the public sector let contracts we go out to open tender in order to find out the best price together with decent quality of service. In this particular case I think we were unable to demonstrate that the best possible price was definitely secure, given the way in which competitive tendering was limited, is that correct?
Mr Quinn: It is correct. I think there was a competition of sorts in 1996 when the contract was first let. It was then rolled over in 1999 and 2002 without competitive tendering.

Q42 Jon Trickett: Eventually this accumulated to a vast amount of money, over £1 million, to a single firm.
Mr Quinn: That is correct. £1.4 million.

Q43 Jon Trickett: So we have £1.4 million of public money being spent and we are unable to demonstrate that we got the best possible value for money that we could. But then there is an extraordinary further development in the sense they were awarded a three year rolling contract. So it never went out to tender again?
Mr Quinn: That is correct.

Q44 Jon Trickett: And, as I understand a rolling contract, what it means is it is always three years unless somebody says, "Right, it now terminates" and then has three years to run, is that correct?
Mr Quinn: Yes, it is.

Q45 Jon Trickett: So a rolling contract is a permanent continuing contract until such point that somebody gives a three year notice of termination?
Mr Quinn: That is correct.

Q46 Jon Trickett: What was the total value of the termination, because it was impossible to tell here, I think.
Mr Morrison: May I just say that your characterisation of a rolling contract is correct. However, the contract was specifically renewed twice by the board of EBT, which conflicts a bit with the notion—

Q47 Jon Trickett: It does. Nonetheless I do not think I can recall encountering an external company tendering for work and then being given a three year running contract, notwithstanding the fact that there were some further developments. Am I right in saying it was about 170 thousand a year?
Mr Quinn: It may have been amended to that, or maybe a little bit more. The Department's view is that LEDU as a prospective funder of EBT should have objected at the outset to that particular form of contract.

Q48 Jon Trickett: Of course they should, and I am trying to establish the extent to which our money, the taxpayer's money, was put at jeopardy. It strikes me that if you had found that the work should be discontinued with this particular company it would have probably cost £500,000 for the public sector to buy itself out of the contract. Is that about right?
Mr Morrison: I do not think anyone knows what it would cost to buy out of that contract. I think your point is quite correct that it is impossible to say what the market value would be without a full tendering process.

Q49 Jon Trickett: Is that not a disgraceful position that we were put into?
Mr Morrison: I would agree.

Q50 Jon Trickett: How did it come about that this was allowed to happen? It is absolutely extraordinary, is it not?
Mr Quinn: Well, it would appear that the International Fund drew up the first list and by the time LEDU became a funder the International Fund's letter of offer to EBT had a stipulation in it that the management contract had to go with MTF, so I still say LEDU as a prospective funder had the opportunity to say, "No, we are not entering into that relationship."

Q51 Jon Trickett: But who drew up the contract? Was it the board?
Mr Quinn: I do not know.

Q52 Jon Trickett: Did the board play any role in letting the contract? They must have known something about it.

Mr Harding: As I understand it the board were responsible for rolling the contract over on the two subsequent occasions.

Q53 Jon Trickett: And the deputy chair of the board was one of the principals of the company?
Mr Harding: Correct.
Mr Quinn: Mr Trickett, it was the EBT board that rolled the contract over. Mrs Townsley was Deputy Chairman of the LEDU board, which was one of the funders.

Q54 Jon Trickett: I just think it is the most extraordinary set of developments I have heard of, anyway, in 28 years of public service. I want to ask about Mr Townsley and Arcom. In November 2000 he bought some shares for £1.08 per share, not for the whole shares, and later on the EBT Venture Fund in principle agreed to purchase not the same shares but shares in the same company at £19.49, and the decision to do that had already been taken, is that right?
Mr Morrison: That is right. In April 2000 the EBT board had decided in principle it would invest. Then later in the year, as you say, Mr Townsley acquired the shares at that price and shortly thereafter, it is true, the board of EBT executed a purchase at £19.49 per share.

Q55 Jon Trickett: The way I read it is Mr Townsley and Arcom discussed the acquisition of shares in August 1999, so in August the previous year; he asked them to put it on hold. The board then decided to buy the shares in April and, having put it on hold, he then acquired the shares at £1.08 subsequent to the board decision. When the board decision was then implemented the value of the shares was £19.49.
Mr Morrison: Yes.

Q56 Jon Trickett: That is a very interesting chronology, is it not, to say the least. Why is that not insider trading?
Mr Morrison: Well, first of all, Mr Trickett, as I say, it is a very troubling chronology and set of facts. I understand that the position of Mr Townsley is that he paid for the shares at a discount in compensation for previous services rendered to Arcom. However, to the best of our knowledge, we have seen no valuation of those services. We are not able to value them independently, and I do not think there was clarity when a decision was made.

Q57 Jon Trickett: If I was to hypothesise a possible series of events, you could imagine a man speaking to his wife, both in the same company, in 1999 and having a conversation: "Well, I have had an offer of some shares in this company"; the wife happens to be a member of a board which subsequently then decides to make an offer for the shares; that information somehow or other gets back to the husband; he then buys the shares apparently at a 20th of the cost almost, and then the board goes ahead and pays £19.49 for them. I could hypothesise that and have no way of knowing whether that would happen, but any casual observer knowing that chronology might well come to same conclusion as my hypothesis, might they not?
Mr Morrison: That is speculation but certainly the look of it is not good and one would have thought there should be some other safeguards such as, for example, an independent appraisal of the shares.
Jon Trickett: Let us put it this way. The Townsleys may have been well protected from such hypotheses had they not chosen to be involved in so many conflicts of interest, and quite frankly the way the public sector handled taxpayers' money would have been protected as well, and so their reputation would not have been dragged through the Committee of Public Accounts or elsewhere on the one hand, and we would have some certainty about expenditure of taxpayers' money had those conflicts of interest not taken place.

Q58 Chairman: That is a very good point. It would not be very difficult for this just to be a criticism of Mr Townsley, but it is really down to you, as the Accounting Officer, is it not? That is why we have these controls, to protect people?
Mr Quinn: I accept that, Chairman, and I have already acknowledged that the standard of administration in LEDU during this period was seriously defective, and I have already acknowledged, as indeed did the Department in 2002, that the oversight of LEDU was less than effective.

Q59 Mr Bacon: Mr Quinn, there are a series of incidents referred to in part two, some of them by Mr Trickett just now, which one might think might be the subject of criminal charges although we are told that the police, for example, have said that at the moment, on the basis of paragraph 11 at any rate, there is no basis for criminal charges but some of these things, even if they are not necessarily criminal, would at least be unethical. I understand Mrs Townsley is a member of the Institute of Chartered Accountants of Ireland, a professional body. These accounting institutes have very strict guidelines. Have you Reported these matters to the Institute?
Mr Quinn: No, we have not done that. What we have done is referred these matters and some others to the Department of Finance and Personnel for its consideration.

Q60 Mr Bacon: You have asked the Department for Finance and Personnel what it thinks?
Mr Quinn: No, to consider what action would be appropriate on behalf of the wider system.

Q61 Mr Bacon: Do you not have an opinion on what action would be appropriate on behalf of the wider system?
Mr Quinn: I have not formed an opinion on that yet.

Q62 Mr Bacon: That is extraordinary. Mr Quinn, in relation to the EBT board there were supposedly practices in place to deal with conflicts of interest involving EBT managers, but they were subject to

guidance from your Department ultimately, were they not? Or should have been? Are you satisfied that the guidance you gave to EBT and to EBT board members was adequate?
Mr Quinn: I am satisfied that there was sufficient guidance in the system. For instance, in 1994 the Cabinet Office issued guidance on the conduct of board members; in 1996 LEDU issued a document called the Responsibility of Board Members; in 1997 the Cabinet Office updated its guidance, and in 1998 LEDU produced a code of conduct, so there was guidance available. I think the problem with EBT was that the potential conflicts of interest were so numerous and some of them were so fundamental that they were probably beyond management.

Q63 Mr Bacon: But it also says in the Report, page 25, in paragraph 2.22: "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". You basically were not providing adequate guidance to the directors, were you?
Mr Quinn: Well, it certainly would have been better if LEDU had indicated it had concerns about the conflicts of interest in the EBT structure. I would not want anybody to have the view that the EBT board did not have a duty of skill and care themselves.

Q64 Mr Bacon: Could I go back to the question of Arcom referred to earlier, and get the chronology clear in my own mind? Essentially it was in November 2000, that is correct, that Mr Townsley purchased the shares?
Mr Morrison: That is correct.

Q65 Mr Bacon: But it was the previous April that he possessed the knowledge that the board had made a decision to buy shares at £19.49 at some point in the future?
Mr Morrison: Correct.

Q66 Mr Bacon: So he knew in November that six months previously there was a decision by this publicly funded body to spend £19.49 per share at some point in the future for shares which he was then paying £1.08 for?
Mr Morrison: We assume that he knew at that stage. Certainly a decision had been taken.

Q67 Mr Bacon: His wife definitely knew?
Mr Morrison: His wife would have known.

Q68 Mr Bacon: Because she was a board member?
Mr Morrison: Yes.

Q69 Mr Bacon: And then in March 2001 the board duly went ahead and purchased these shares at £19.49 11 months after it agreed it would do so. What was the reason for the 11 month delay?
Mr Morrison: I am not sure about that exactly.

Q70 Mr Bacon: You are not sure?
Mr Morrison: No. I think it is to do with the needs of the company when it needed the shares to be purchased, to do with the corporate finance needs of the company, when equity was required to be in the company.

Q71 Mr Bacon: I used to work in a corporate finance department many years ago, and I was not a very eminent but one of the things I was aware of was that pricing matters were decided very close to what is called financial close. Why would this have been agreed 11 months beforehand?
Mr Morrison: I, like you, had this background and I would have thought that one would have wanted to re-up the pricing having executed the deal one year after the price had been determined. I find it quite strange.

Q72 Mr Bacon: Would you agree, if someone were aware that the board had made a decision some time in the future to buy shares at £19.49 and in possession of that knowledge had then purchased them earlier than that at a much lower price that would have constituted insider trading?
Mr Morrison: It is very complicated chronology. The difficulty and the complication in this is that I understand Mr Townsley purchased those shares at a discount in recognition of services rendered in the past.

Q73 Mr Bacon: You said this to Mr Trickett, but you have been unable to identify what these services were?
Mr Morrison: We do not know. We do not understand what they were exactly and we have seen no valuation thereof, so we are not in a position to comment.
Mr Quinn: A number of these actions and transactions were private matters which would almost by definition be outside the line of sight of public officials.

Q74 Mr Bacon: But it was public money, was it not?
Mr Quinn: Yes.

Q75 Mr Bacon: If I can pursue this a little bit further, paragraph 2.10 at the bottom paragraph talks about: "The risks of the sector and in particular the company at that time"—that is the risk of the company—"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 the Department of Trade & Industry." is this not basically a case of EBT offloading a huge risk directly to the Department of Trade & Industry, disregarding the fact it was public money?
Mr Quinn: Our understanding is that EBT was a qualified lender within the DTI scheme, and as such I think it would have had a duty to provide the DTI with all the necessary information in relation to any

grant proposal or loan proposal that it had passed to them. We just do not know whether that was done or not. Making a speculative point, we would regard the LEDU representative on the EBT board as having a particular responsibility to ensure that that would have been done.

Q76 Mr Bacon: I gather that one of the companies, Fusion, which was supported by EBT was also supported by two other venture funds which were funded through your Department—Nitech Growth Fund, which is apparently Invest Northern Ireland's own fund, and also Veridian Growth Fund. Were you aware that three different publicly funded bodies were investing in this company in which Mr Townsley had a stake?
Mr Harding: Through routine case work we would be aware that other venture capital funds are going to be providing funding, and we knew about the origins of those, whether public money or not.

Q77 Mr Bacon: In this case did you know that you had three publicly funded venture capital funds who were bank-rolling this company which was one in which Mr Townsley had an interest? Yes or no?
Mr Harding: Not on this occasion. We did not know at that time the EBT were making that deal, but I was talking generally about now situations where we would know what publicly funded venture capital funds were investing. At that time the answer is no.

Q78 Mr Curry: I would like to think that all this stems from some sort of structural failing and that the guidelines and the geometry of behaviour, as it were, was not there but when I read this Report I do not believe that. I think it was perfectly clear how things ought to have carried on, and I think a number of individuals simply decided they were not going to obey those particular rules, or they were going to shortcircuit the rules. I note in paragraph 1.47 it says: "This failure was compounded by an extraordinary series of lapses". Now, a lapse is a personal bit of behaviour. Unless a pilot becomes ill an aircraft does not crash because of a lapse; it crashes because of structural failure. Would you agree this looks to be a whole series of individuals simply misbehaving?
Mr Quinn: I certainly think that a number of individuals did not do everything they should have done to make sure that the governance structure of EBT and the funding arrangements from LEDU to EBT were as they should have been. Can I distinguish between the possibility that they may have just lacked insight into the matters as distinct from making a positive decision not to do the right thing?

Q79 Mr Curry: I find the word "insight" a bit difficult in these circumstances, I have to say. I am not sure that when I am looking at the way government behaves, insight is the sort of quality I would normally attribute to it or expect from it and almost never witness as a matter of fact. What I do expect is honesty and the common sense observance of rules. Now, this brings me to my second suspicion, which is that Northern Ireland is a very small society and the government business community is all frightfully incestuous and everybody knows everybody else, and it is very easy for people who might well meet on all sorts of different social levels to transfer into their business or professional relationships perhaps an informality which you would not find in a rather larger pool. Is that a wrong piece of insight?
Mr Quinn: I think the fact that Northern Ireland is a relatively small place with a relatively small business community is fair comment. I cannot draw an inference from it in respect of the matters described in this Report because the Report itself does not ascribe any significance to that particular point.

Q80 Mr Curry: The reason I ask is because in paragraph 1.46 the Comptroller and Auditor General says that the former LEDU must have been well aware of the conflict because it had objected to an analogous appointment. So it was not that it was incapable of acting or did not know the rules. Either one got under the radar or there were reasons why it was not caught on the radar, and I do not think you know which it was, to be honest.
Mr Quinn: I accept that the knowledge of a particular conflict registered in the FPM case should have led inevitably to the same line being taken in respect of the MTF. There is not, as far as I can discern, a satisfactory explanation for why LEDU did not raise the same objection in both cases.

Q81 Mr Curry: Would these appointments have been subject to ministerial approval?
Mr Quinn: Which appointments?

Q82 Mr Curry: The appointments to the various boards.
Mr Quinn: I think the appointments to the LEDU board would be subject to ministerial approval. The appointments to the Emerging Business Trust Board would not have been.

Q83 Mr Curry: If a list of appointments had been given to a Minister to approve there would have been a commentary, no doubt, attached from the people making the recommendation, and that commentary would have alerted the Minister to any criticism there might be of conflict of interest?
Mr Quinn: Yes. The Commissioner for Public Appointments issued guidance in 1996 which covered conflicts of interest, and public appointments after that should have addressed potential conflicts of interest. Unfortunately the records in relation to some of the appointments in the late 1990s were not complete, but it is clear that potential conflicts of interest were addressed in respect of Invest Northern Ireland appointments in 2002.

Q84 Mr Curry: So it is prior to that that we think that may not have happened?

Mr Quinn: It may or may not have happened.

Q85 Mr Curry: But had we got the record we would have known there was a note to the Minister saying: "You may wish to be aware, oh Minister, and take this into account."
Mr Quinn: I would surmise that did not happen for this reason; that if LEDU had identified a fundamental conflict of interest between Mrs Townsley's membership of the EBT board and her provision of management services through MTF, then I think they would have intervened and objected at large.

Q86 Mr Curry: Do you think, Mr Quinn, in general terms that in Northern Ireland, with brief moments when Stormont had responsibility but most of the time not, is there a sense of the administration being on some sort of automatic pilot and perhaps people taking decisions which normally might have been referred elsewhere?
Mr Quinn: I do not think so. I have no evidence of that at all.

Q87 Mr Curry: Regarding this share purchase which we are all getting a little bit concerned about, you said that Mr Townsley acquired these shares and apparently the discount was due to the fact that this was a remuneration in kind of some sort?
Mr Morrison: Right.

Q88 Mr Curry: If it were, it would be declared for tax purposes, would it not?
Mr Morrison: I am not sure about the tax.

Q89 Mr Curry: Well, it would be, because if I am given a car that is declared on my tax forms. So Mr Townsley could clear this up, could he not, if he invited people to inspect his tax returns for the relevant year?
Mr Morrison: I cannot answer that specifically.

Q90 Mr Curry: The reason I am asking is that he bought his shares at a certain time and they were purchased by the board at a certain time. Was there anything which determined that they had to be bought at these times? Was there a point at which the share option, which is what it appears to be, had to be exercised?
Mr Morrison: I do not think there was any form of option here. I do not think the timing was in relation to an option which would lapse.

Q91 Mr Curry: So he had a choice as to any purchase, as far as you know?
Mr Morrison: As far as I know, and I am rather speculating here, the timing of the purchase must have had something to do with the corporate finance needs of the company.

Q92 Mr Curry: Yes, he did not spend much. He did not do a great deal for the corporate finance needs of the company if it needed £2,500 as badly as that, did he?
Mr Morrison: True, and as you know the subscription of the EBT, which came hard on the heels, raised about £50,000.

Q93 Mr Curry: The reason I ask these questions is it is quite clear that the sequence of events makes one very concerned about what happened and it must be in the interests of everybody to be able to clarify that, and I was merely suggesting a route by which Mr Townsley could dispel any notion that he was buying these shares or exercising this option in the knowledge that they would become quite rapidly worth 15 or 16 times as much?
Mr Quinn: That would be for Mr Townsley as a private citizen, of course.
Mr Curry: I appreciate that. Thank you.

Q94 Chairman: You said records were lost? What records? When?
Mr Quinn: I am not sure they were lost. We tried to track down the files relating to Mrs Townsley's appointments or reappointments to LEDU during the 1990s, she was first appointed in '93, reappointed in '96 and reappointed in '99, and we had limited success in tracking those down.

Q95 Chairman: Were other files lost in that period? Is this usual?
Mr Lavery: It is not usual that none of the files were available.

Q96 Chairman: What do you mean, "It is not usual"? If it is not usual, why were these files lost?
Mr Lavery: I think the files may have been destroyed because they were over five years old.

Q97 Chairman: So were other files of this period also destroyed?
Mr Lavery: Yes.

Q98 Mr Williams: Mr Quinn, there seems to have been an explosion of companies created around about this time. We had to go to the Sharman Committee ourselves about publicly-owned companies of this time, because that is the one format other than charity that takes them outside the scrutiny of the Audit Office. Was that a factor in that decision being arrived at?
Mr Quinn: I do not believe it was.

Q99 Mr Williams: You were not there at the time, were you?
Mr Quinn: I was not but I referred earlier to the organisational culture of the European Peace Programme and the International Fund for Ireland. Almost as an act of policy they were operating through third party organisations as a way of reaching out to the Northern Ireland community, but I did not think there was much more to it than that.

Q100 Mr Williams: Well, it certainly worked out to be a very convenient arrangement. So now you are dependent on external auditors doing the work that the National Audit Office would do. Who appointed those?
Mr Quinn: The companies themselves.

Q101 Mr Williams: Who?
Mr Quinn: The companies themselves would appoint their external auditors.

Q102 Mr Williams: Would the Department have a say in it?
Mr Quinn: No, I do not think it would under normal company practice.

Q103 Mr Williams: It would be the board and, therefore, in particular the senior members of the board who would have been selecting the auditors?
Mr Quinn: Yes. Could I just come back briefly, Mr Williams, on the convenience point. We have issued fresh guidance to the Department and to its NDPBs on dealing with third party organisations and one of the things we are insisting on is provision for the Northern Ireland Audit Office access to their books.

Q104 Mr Williams: So I assume these auditors changed at regular patterns so they did not become part of the family and they were not allowed to continue indefinitely, was that the case?
Mr Morrison: That is really up to the decision of the board. It has become the practice among large companies to rotate auditors but it is not necessarily a requirement, or it was not at that time.

Q105 Mr Williams: There is always the danger and we observe this, and the National Audit Office observe this, you cannot have your auditors for too long because there is a danger of cosiness. It is a natural development of the relationship. It looks as if the auditors sleep walked through an incredible range of, what can we call them, weird judgments. First of all they did not notice that the body was acting *ultra vires* in giving loans that were above the ceiling that was set down for them, did they?
Mr Quinn: That is correct.

Q106 Mr Williams: That was not in just one area, it was in a couple of areas.
Mr Quinn: Yes.

Q107 Mr Williams: Is it not something you would have expected auditors to have picked up?
Mr Quinn: Yes.

Q108 Mr Williams: Perhaps I should ask Mr Dowdall.
Mr Dowdall: Certainly we are very hot on anything that is *ultra vires* and we would have expected to pick up things like that.

Q109 Mr Williams: *Ultra vires* is one of the cardinal sins in government, is it not?
Mr Quinn: The point that we would have hoped the external auditors would have picked up would have been the apparent absence of a fully functioning bad debt policy and the treatment of bad debt in EBT books.

Q110 Mr Williams: So did the auditors draw the attention of the accounting officer, for example, to the fact that normal rules on competitive tendering were not being observed?
Mr Quinn: No. I am assuming that the auditors of EBT regarded their duty as being to the company, not to the funding bodies.

Q111 Mr Williams: So who should have drawn it to your attention?
Mr Quinn: I think the LEDU representative on the EBT board, as the Report says, was well placed to observe a number of matters.

Q112 Mr Williams: Is he still there?
Mr Quinn: He is not.

Q113 Mr Williams: When did he leave?
Mr Morrison: He stepped down in November 2003. He finally resigned in November 2004.

Q114 Mr Williams: There was no signed contract with Mrs Townsley's company. How on earth could that slip through?
Mr Quinn: It was just bad practice. When the IFI issued its Letter of Offer to EBT in 1996 it appended a draft contract but that was never signed by the parties concerned. Even if it had been, I think what the Invest Northern Ireland examination suggested was that it was not sufficiently robust and comprehensive to support a contract on this scale.

Q115 Mr Williams: You said it was drafted but who drafted it?
Mr Quinn: We do not have direct knowledge of that. What we do know is that it was attached to the International Fund for Ireland's Letter of Offer.

Q116 Mr Williams: But it had to be drafted before she was due to join the organisation.
Mr Quinn: Yes.

Q117 Mr Williams: So there was a lapse by whoever was administering at that stage.
Mr Quinn: Yes.

Q118 Mr Williams: Who was responsible?
Mr Quinn: I could surmise that the International Fund staff, perhaps even the Business Enterprise Team, may have drafted the contract but we just do not know. In any event, our view is when the contract was seen it should have been queried.

Q119 Mr Williams: In this whole process, has anyone actually been disciplined?
Mr Quinn: Yes. The Department is not the employer so—

Q120 Mr Williams: I am not asking who, I am asking if they had been.
Mr Morrison: The representative of LEDU and then Invest NI who was on the board of EBT is on suspension with pay. He is also related to one of the three further investigations that are mentioned in paragraph 11. I am not taking any further action there until I see what the outcome of that is and I want to understand what cumulative effect there might be.

Q121 Mr Williams: It is difficult to understand, particularly as the Chairman has said the Report on proper conduct in public business, public affairs, had made clear so many of these pitfalls. It seems as if in Northern Ireland you just ignored all of these things, they just did not apply to you. Why not?
Mr Quinn: I think the Audit Office's Report makes the point from the Audit Office's point of view that what this Report reveals is not representative of the standard of administration in the Northern Ireland public service, and we do not believe it is. They make the equally valid point that once Invest Northern Ireland got sight of these things they immediately realised that there were problematic issues that needed to be investigated.

Q122 Mr Williams: Would your predecessor have been there throughout this period? When did he join and when did he leave?
Mr Quinn: My immediate predecessor was in 2000.

Q123 Mr Williams: He should have been looking for errors of this sort, should he not?
Mr Quinn: Appendix 3 to the Report, which cross-refers to the other issues affecting LEDU and the Tourist Board, puts a timeline on it. It says 1995–2002, so we think that most of the things that went wrong went wrong during that period. Some of them have a reverberation beyond 2002 but that was because they were being investigated and remedied.

Q124 Mr Williams: During that period would you say the Department had been dilatory or outright incompetent?
Mr Quinn: What I would do is really stand on the formal memorandum provided by the Department to the Assembly PAC in December 2002. They acknowledged that there were material deficiencies in the oversight of NDPBs during the material time.

Q125 Mr Williams: Did anyone near the top take premature retirement?
Mr Quinn: No, I do not think so.

Q126 Mr Williams: Your predecessor served his whole term then?
Mr Quinn: Yes, I think so he had been there for some time.

Q127 Chairman: Tell us what has happened to the careers of some of the people responsible: Mr Gerry Loughran, Departmental Accounting Officer for your Department, 1994–2000; Mr Bruce Robinson, June 2000 to January 2006 when it was taken over; LEDU Accounting Officers, Mr Chris Buckland, 1994 to 1 April 2001; Dr Alan Neville, 2 April 2001 to 31 March; LEDU Chairmen, Mr Paul McWilliams, 1994–1998 and Mr Eamonn McElroy, 28 February 1998 to March 2002; Invest Northern Ireland Chairman, Professor Fabian Monds, 1 August 2001 to 31 December 2005? What has happened to these people subsequently?
Mr Quinn: The Chief Executive of LEDU has now retired. Dr Neville is on precautionary suspension. Gerry Loughran went on to the Office of the Deputy First Minister as head of the Northern Ireland Civil Service. Bruce Robinson went to the Department of Finance. Professor Monds retired having served his term as Chairman of Invest Northern Ireland.

Q128 Chairman: So nobody has suffered any damage to their careers as a result of this?
Mr Quinn: I think that is not the case.

Q129 Chairman: Apart from this one person who has been suspended.
Mr Morrison: No, that is not quite right, Chairman. One other person has been disciplined formally.

Q130 Chairman: Who is that?
Mr Morrison: He was the former head of the business development division of LEDU.

Q131 Jon Trickett: I want to go back to Arcom and this mysterious—or perhaps not mysterious—variation in the cost of the shares. My questioning was terminated by time and I only managed to get about half of the story out it seemed to me. First of all, MTF, the accountancy firm which was working for the public sector, had had a relationship with Arcom for quite some time previously, had they not?
Mr Quinn: Yes.

Q132 Jon Trickett: Can you very briefly describe that relationship? Were they advisers? Were they accountants? What were they doing? I am talking about from June 1996 to early 1998, paragraph 2.13.
Mr Harding: It is clear from the PwC investigation that MTF provided some services to Arcom.

Q133 Jon Trickett: What were the services? Were they accountancy services?
Mr Harding: There were a number of services being provided: broad based consultancy services, management information systems and things of that nature.

Q134 Jon Trickett: So Mr and Mrs Townsley's company had had a two year financial relationship with Arcom prior to these share manoeuvres?
Mr Harding: That is what the PwC Report said.

Q135 Jon Trickett: At the time of the acquisition of the shares, a subsidiary of MTF was trading with Arcom. Is that a fact as well?
Mr Harding: There was another company referred to in the PwC Report that was providing some services.

Q136 Jon Trickett: Was it wholly owned by MTF?
Mr Harding: Yes, I understand it was.

Q137 Jon Trickett: Were Mr and Mrs Townsley shareholders and directors of this subsidiary company?
Mr Harding: It was a subsidiary company so I am not sure exactly how the shareholdings panned out.

Q138 Jon Trickett: It is not quite clear in paragraph 2.11 but there had been a two year relationship between the main MTF company, if I can describe it as that, and Arcom. There was then an ongoing trading relationship between a subsidiary of MTF and Arcom at the time of the share acquisition when these decisions were being taken by the board. Is that correct?
Mr Harding: The PwC Report confirms those findings.

Q139 Jon Trickett: Then, extraordinarily, having paid £19.49 for the shares which Mr Townsley paid £1.08 for, Mrs Townsley comes back to the board and recommends a fast track loan to Arcom of a further £25,000. Is that correct?
Mr Harding: Those are the facts that have been highlighted.

Q140 Jon Trickett: Then the company went bust.
Mr Harding: To my knowledge it is as you describe.
Jon Trickett: Apart from the fact that this is an absolutely extraordinary set of innocent relationships, if innocent is the right adjective to use, has any thought been given to the quality of Mrs Townsley's advice about the nature of this company at the time at which a further £25,000 was handed over to them? The loan was made in February 2003 and the company went bust in September of the same year with total losses to the public sector of £100,000. Has somebody gone back and looked at whether this advice was sound advice at the time or whether there is a case for civil action against the Townsleys, MTF or any other adviser related to the Townsleys? Has that been explored? There is a phrase in here about, "the board were made aware that there was a risky sector", but the company went bust a few months after this £25,000 fast track loan had been recommended by Mrs Townsley herself. Her and her husband had intimate knowledge about the company, they were shareholders, they had a business relationship in the past, and they were trading through a subsidiary with Arcom. Has any thought been given to the fact that this may well have been negligent advice?
Chairman: I am sorry, you cannot just shrug again, you are here to answer questions.

Q141 Jon Trickett: We have been given advice that they have lost £100,000, made a £25,000 fast track loan, paid all this money for blinking shares, Mr T is well engaged in this company, very deep into it, and Mrs T's two separate companies are trading with Arcom from time to time and she is advising them on the £25,000. Do you not feel extremely unsettled and should we not be looking at every word, jot and tittle that she has advised the board on and the public sector about this further £25,000?
Mr Morrison: Can I say, Mr Trickett, any company that needs a fast track loan needs it because it is in difficult financial circumstances. Clearly the way things panned out it was a bad decision. It is always very easy after the fact to say that. I would say that the set of circumstances that you describe I find disturbing.
Jon Trickett: I am sure the Committee will think the word "disturbing" is an English understatement really.

Q142 Chairman: Mr Quinn, you are new to all of this. It must have been a shock to you to come to this new Department with this Report from the Comptroller and Auditor General appearing on your desk. Would it be an overstatement to say that some of the controls that your predecessors were exercising were more akin to those pertaining in a Banana Republic than in a department of state in the United Kingdom?
Mr Quinn: The Report is rightly critical but it is also precisely critical. It is very specific about what was done wrong and what was not done right. I prefer to take a rather more analytical approach to it because the issues are serious and they deserve serious consideration.

Q143 Chairman: How are you going to restore confidence in your Department now you have taken over? I presume that you are here to do that, what are you going to do?
Mr Quinn: I would make two broad points. One, I think the Department made the first step in restoring confidence when it recognised in December 2002 that its oversight of its NDPBs had not been up to scratch. I think that was a first important step. Two, if you read paragraph 17 and the very long list of steps the Department has taken since then, which we continue to take, that is essentially the agenda that we have for restoring confidence in the Department's oversight of its NDPBs. I am in no doubt that my colleagues in the Department and in the NDPBs are now fully aware of the standards of public administration, governance and financial control that I would expect.

Q144 Mr Williams: The Sharman Committee, which was set up to look at accountability of all public functions, recommended that all government companies should in future be audited in the UK by the National Audit Office. The same applied, Mr Dowdall, to yourself. Have you now got full auditing rights to all the companies or are there any that are still outside your reach?
Mr Dowdall: The key thing in relation to this case is that I have full auditing rights in relation to INI, the successor body to LEDU, which is a full NDPB. I would now have the right to audit any government company set up as a company limited by guarantee.

Even the Sharman Rules would not have given me the right to audit EBT. I think the changes introduced at the time of Sharman would have given me unequivocal access rights so that if there was any hint that anything was wrong I would not have had to negotiate my way in, I could now go in and investigate them.

Q145 Mr Williams: This Committee wants to be reassured that you now have all the access you require that is permissible under the Sharman recommendations.
Mr Dowdall: Yes, I have.

Q146 Mr Williams: There is nothing left outside now, because if it is we would like to focus on it obviously in view of this situation and make recommendations.
Mr Dowdall: I know the work that you have done to ensure that the National Audit Office has these full rights in GB. That has been implemented in parallel in Northern Ireland and there is just one more step to go in both GB and Northern Ireland, as you know, in terms of auditing companies, which is in hand at the moment.

Q147 Mr Bacon: Mr Quinn, the total funding to EBT was in the region of £4.35 million, is that correct?
Mr Quinn: That is correct.

Q148 Mr Bacon: How much of that went to the accountancy practice controlled by Mrs Townsley?
Mr Quinn: I think the figure is £1.4 million.

Q149 Mr Bacon: £1.4 million out of the £4.35 million.
Mr Quinn: Yes.

Q150 Mr Bacon: In other words, around a quarter of the total monies that were made available for this small business regeneration went directly to this accountancy practice. Is that correct?
Mr Quinn: Yes.

Q151 Mr Bacon: It says that you are hoping to get back some monies through the liquidator. What is your best estimate of what you will recover?
Mr Quinn: I think we are hoping to recover about £1.9 million. I look to my right. The difference between what we put in and the likely recoverables is in the region of about £2.4 million

Q152 Mr Bacon: Are you hoping to recover any monies from Mrs Townsley or Mr Townsley?
Mr Quinn: I do not think there is action in train along those lines.

Q153 Mr Bacon: Do you anticipate that there will be?
Mr Quinn: I will turn to Invest because they are dealing with the liquidator.
Mr Morrison: I think it is for the liquidator to decide whether any Reporting action is necessary in relation to the directors of EBT. We are not intending to take any action.

Q154 Mr Bacon: Could you repeat everything loudly, please, because I cannot hear what you are saying.
Mr Morrison: Sure. It is up to the liquidator to decide whether it needs to Report any potential action in relation to the directors of EBT. That is its duty. For our part, we are not expecting to take action at this stage.

Q155 Chairman: I think that concludes our hearing. It seems to me that this is one of the worst cases of conflict of interest and impropriety this Committee has seen in a long time. It is deeply worrying to us that this went on for many years under the noses of supposedly close oversight by your officials. You allowed LEDU to operate outside the Code of Public Conduct which every accounting officer is charged with upholding. You can expect our Report to indict your Department for serious dereliction of its responsibilities. I assume you have been sent to clean up this mess so we will judge you on the quality of your response. Do you wish to say anything further?
Mr Quinn: No, thank you.
Chairman: Thank you. That concludes our hearing.

Letter from the Permanent Secretary, Department of Enterprise, Trade and Investment to the Clerk of the Committee

Following consultation with the C&AG and the Treasury Officer of Accounts, I think it is appropriate to draw your attention to a number of development which may result in action against individuals involved in this case:

— The EBT Loan and Venture Funds were operated by two limited liability companies. The NIAO Report will note that both companies are now in insolvent liquidation and are currently the subject of examination by the Liquidator. This opens up the possibility that, depending on the Liquidator's conclusion, the Department's Insolvency Service, in consultation with the Liquidator, may have to consider bringing disqualification proceedings against one or more of the Directors of the companies.

— The Report will refer extensively to MTF Chartered Accountants, a firm which provided management services to EBT, and will refer by name to it two partners (one of whom was also a Director of the EBT Loan and Venture Fund companies). It is possible that DFP will draw the NIAO Report to the attention of the Institute of Chartered Accountants in Ireland or that the Institute will consider the issues on its own account.

— The Report will also refer, though not in detail, to investigations currently under way in respect of three other bodies. Two of these cases have been referred to Inspectors appointed under NI companies legislation. The third has been referred to the Police Service of Northern Ireland. In respect of the third case, two members of former LEDU staff, now employed by Invest NI, are currently on precautionary suspension, pending the consideration of the need for disciplinary action.

My intention is, of course, to provide full and frank evidence to the Committee but I am also conscious of the need to avoid prejudice to the possible civil, professional, criminal and disciplinary proceedings which might flow from the considerations listed above.

You may wish to draw these factors to the Committee's attention and I am, of course, available to discuss them with you if you would find that helpful.

Stephen Quinn
Permanent Secretary

1 February 2006

Letter from Mr Billy Bell OBE MLA to the Chairman of the Committee

Having had the pleasure of meeting your Committee when you last visited Stormont, I am taking the liberty of writing to you about the C&AG's recent Report on this subject. As Chairman of the Assembly's PAC while it was in operation, I found the Report deeply disturbing. This is a view which I know will be shared by many of my colleagues in the Assembly. I am very pleased that you have decided to hold a hearing on this subject.

As you will have noted, the Report presents the findings of an investigation into a breakdown of governance and a failure to ensure the proper conduct of public business. I know that your Committee will probe thoroughly the reasons for this and will identify appropriate lessons. However, it may be helpful if I draw to your attention that this case is not unique. During devolution, the Department concerned was severely criticised, on a number of occasions, by our PAC for failures and abuses which are remarkably similar to problems revealed in this latest Report:

— Its failure to deal effectively with a series of major internal frauds in exactly the same Local Enterprise Development Unit which is the focus of your hearing (PAC, Eleventh Report, Session 2001–02).

— The Department's failure to tackle what we described as "blatant examples of malpractice and impropriety" in another of its NDPB's—the Tourist Board. There were also serious conflicts of interest involving the Chairman of the Board. We had to conclude that there was a culture of incompetence and lack of respect for proper procedures which appeared to extend right to the heart of the Department itself (PAC, First Report, Session 2002–03).

An audit report on another company (Into the West Ltd) set up by the Department's Local Enterprise Development Unit also revealed astonishing failures of governance and impropriety. The Report pointed to the inadequacy of the supervision and control arrangements exercised by LEDU.

All of the above cases relate to a period in the 1990s and into the present decade when the Department seems to have exercised no effective oversight of the major NDPBs which it was funding. The opening comment of our PAC Report on the Tourist Board case was that—"*This Report deals with a catalogue of serious failures of management, corporate governance and financial control that should never have been allowed to occur, to the extent that it did, for as long as it did in any part of the public service*". I have concluded that there was a long standing weakness in the way in which the Department of Enterprise, Trade and Investment discharged its oversight responsibilities. It is very worrying that the Department and agencies which carry responsibility for promoting the region's economic development should have repeatedly demonstrated that they were unable to carry out their core functions to the standard expected in public life.

I hope that the Department of Enterprise Trade and Investment will be able to demonstrate that, with the replacement of LEDU by Invest Northern Ireland, it is finally dealing with these weaknesses.

The Report which your Committee will produce will be an important opportunity to ensure that the Department gives you a firm undertaking that all the actions which are necessary to restore public confidence are being taken.

Billy Bell OBE MLA

Letter from Mrs Teresa Townsley to the Chairman of the Committee

I understand from the NIAO that you will have sight of the NIAO's Report on or about 8 February 2006 and will consider it at a meeting of your Committee scheduled for 13 February 2006.

Which 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.

The NIAO has indicated that they have relied on a consultants report which has been directly challenged by myself. This challenge was initially made in response to extracts of this consultants report and more recently in my response to the first draft NIAO Report received by me on 14 December 2005. The responses made were not merely "my view" but referenced to evidence and documents to support each response.

I asked the NIAO if they had a responsibility to investigate and address my assertions, where those assertions directly join issue with what purports to be the findings of a detailed and lengthy investigation by the firm of consultants. In their recent response to the NIAO commented, "We have considered [her] letter point by point, where appropriate checking documentary material and asking for further clarification from the Department and the consultant, and reached a view on whether or not in our opinion any particular part of the Report requires amendment."

The final draft of this NIAO Report, which I received on 24 January 2006, clearly shows that the invitation to investigate my assertions and look at the related evidence appears not to have been taken up. I am further concerned by changes and additions to this current draft Report from the last draft which I consider add innuendo and forms of wording which could be misleading. I was informed by the NIAO in a letter dated 20 January 2006 that "it is not normal to engage in repeated rounds of third part clearance". I was also informed in the same letter to address all further correspondence regarding procedural aspects of the Report to a London firm of solicitors.

I do not believe there has been "natural justice" to date and I write to you, as Chairman of the Parliamentary Committee of Public Accounts at Westminster to seek to attend when this Report is presented and I would be willing to be questioned.

Teresa Townsley

26 January 2006

Supplementary memorandum from the Department of Enterprise, Trade and Investment

Supplementary question from Mr Richard Bacon: Does Mrs Teresa Townsley hold any other official posts involving the stewardship of public money?

At the end of the Committee of Public Accounts evidence session on 13 February she was honorary treasurer of Queen's University, Belfast. She has held this position since June 2000 but resigned on 22 February 2006.

Mr Stephen Quinn
Permanent Secretary

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