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EUROPEAN UNION STRUCTURAL FUNDING: PROGRESS ON SECURING THE BENEFITS FOR WALES

Report by the National Audit Office Wales on behalf of the Auditor General for Wales

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The Auditor General for Wales is totally independent of the National Assembly. He certifies the accounts of the Assembly and its associated sponsored public bodies; and he has statutory authority to report to the Assembly on the economy, efficiency and effectiveness with which the Assembly and its sponsored public bodies have used their resources in discharging their functions.

This report was prepared for the Auditor General for Wales by the National Audit Office Wales.

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Contents

Executive Summary

1 The European Union's Structural Funds support activities that are designed to reduce structural inequalities between different regions and social groups. They are delivered through seven-year programmes agreed between the member state and the European Commission - the current programming period runs from 2000 to the end of 2006. There are seven programmes in Wales which are administered by the Welsh European Funding Office (WEFO), part of the Welsh Assembly Government, which is directly accountable to the European Union for the management and financial control of these programmes. Partnership is a fundamental concept that underpins the running of the programmes in Wales. WEFO draws on the support of its partners in the public, private and voluntary sectors at all stages, and involves them in developing strategy, selecting projects and, to a lesser extent, in monitoring and evaluating progress.

The Structural Funds

European Regional Development Fund (ERDF), which aims to reduce regional inequalities in development

European Social Fund (ESF), which aims to improve employment prospects across the European Union

European Agricultural Guidance and Guarantee Fund (EAGGF), which assists the development and diversification of communities in rural areas

Financial Instrument for Fisheries Guidance (FIFG), which assists the restructuring of the fishing industry

The programmes in Wales

Objective 1, operating in West Wales and the Valleys, which aims to assist the development and structural adjustment of regions whose economic development is lagging behind

Objective 2, operating in parts of East Wales, which aims to support the economic and social conversion of areas hardest hit by urban and industrial decline, restructuring and the loss of traditional activities in rural areas

Objective 3, operating in all areas outside the Objective 1 area, which aims to combat long term unemployment by tackling such issues as social exclusion and equal opportunities, and by promoting lifelong learning

There are also four much smaller programmes, known as Community Initiatives

2 This programming round is the first in which West Wales and the Valleys benefits from Objective 1 status - granted to the poorest regions of Europe - and the Objective 1 Programme accounts for 84 per cent of the £1.5 billion of Structural Funding that is available to Wales for the 2000-06 period. This represents a major increase from the £395 million available in the 1994-99 period, and the country faced major challenges in launching the current programmes. In response to widespread public interest in the progress of the Objective 1 Programme, we reported in June 2002 on the key risks facing WEFO in its management of the Structural Funds. The National Assembly's Audit Committee took evidence on the report and issued its own report in December 2002. This report reviews the progress made since then and focuses on the areas of concern raised in our own report and that of the Audit Committee.

3 We have clustered the relevant issues in the context of four important aspects of WEFO's management of the current Structural Fund programmes:

- **supporting the process** through adequate staff resources and sound information systems;
- **getting the right projects** by helping applicants to find match funding, engaging the private sector, making access to the Funds as simple as possible and appraising projects rigorously;
- **helping to deliver what is promised** by providing efficient monitoring and control arrangements that offer support to projects whilst ensuring that they comply with the rules; and
- **using all the money available** by ensuring that Wales avoids decommitment and benefits from the Performance Reserve.

Supporting the process

4 **WEFO has enough staff to fulfil its functions but vacancies in some areas have created particular pressure.** WEFO struggled to recruit enough staff as the programmes got underway in 2000 and 2001, but since then the position has stabilised with a vacancy rate of between six and eight per cent for fully operational areas of the business. A high level of internal staff turnover - partly due to the relative ease with which employees may transfer to other parts of the Assembly - as well as a lengthy recruitment process has contributed to this level of vacancies. WEFO has managed the shortfall by re-prioritising and re-allocating work, and has succeeded in delivering its core services and meeting important deadlines.

5 **WEFO has made progress in developing its management information systems but further improvements are necessary.** WEFO inherited a series of disjointed systems that were not fit for purpose, and has implemented a new management information system that substantially addresses these weaknesses. There is scope for further improvements, such as tailoring the ESF system to meet WEFO's needs and integrating it fully with systems for the other Funds. WEFO had hoped to upgrade its current systems and introduce a fully web-enabled system in 2004 which would allow project sponsors to submit grant applications and claims over the Internet, thereby eliminating a lot of WEFO's data entry and checking. However, all new IT projects in the Assembly must now be developed within the framework of the Merlin contract. This will result in a longer timescale but offers the opportunity for WEFO to develop a single, customised system that is much better suited to its needs. WEFO now anticipates that a web-enabled system should be in place by 2007 at the start of the next programming round.

Getting the right projects

6 **The amount of match funding has not constrained the programmes so far, but tighter budgetary management will be necessary to ensure that this remains the case.** The Structural Funds provide about 47 per cent of the total cost of the programmes; the remaining £1.75 billion, known as match funding, comes from domestic sources, of which 70 per cent is planned to come from the public sector and 30 per cent from the private and voluntary sectors. Project sponsors are responsible for securing their own match funding, but the Assembly Government has a key role in providing information, monitoring the overall availability of match funding and in providing much of the public sector input directly. The Assembly Government established a number of special budgets specifically to provide match funding for the period to March 2004. These budgets were under-used until 2003 as project expenditure was slow to materialise. Since then, the match funding position has tightened considerably for several reasons, including an increase of £30 million per year in the overall match funding requirement (to cover the likely increase in the Structural Funding available to Wales as a result of the lower £/€ exchange rate). Nevertheless, the Government remains confident that enough match funding is available for the whole period, although some transfers from under-spent economic development and transport budgets may be necessary to meet shortfalls.

7 **Many private sector-led projects have been approved or are in the pipeline, and private sector match funding is on course to meet targets.** Good progress has been made in engaging the private sector which had provided 35 per cent of the total match funding at 31 March 2004 against a target of 30 per cent; in total, by March 2004, 141 private sector-led projects had been approved, with a further 126 under appraisal or development. WEFO also supports a network of facilitators, working within local Chambers of Commerce, who encourage private sector participation in the programmes. Slower progress has been made with project commissioning, whereby WEFO specifies a project that needs to be delivered and invites the private sector to bid for grant to deliver it. None of these "template projects" have yet been delivered, although the bidding procedure has been developed and WEFO hopes to have eight projects in place by 2005. Experience shows that extensive preparatory work is necessary, but WEFO expects this to pay off by leading to high-quality projects that meet specific needs that would be difficult to meet in other ways.

8 **WEFO has kept the project appraisal process under review and has simplified the system for Objective 1.** The length and complexity of the process was a major concern of applicants and partnerships when we published our 2002 report. WEFO has responded by reducing the number of partnerships and simplifying the project development and appraisal process. Several stages have been combined and others overlap so that the overall process should be shortened.

9 **WEFO has improved the Objective 1 application form for ERDF, EAGGF and FIFG, but there are no plans to replace the problematic ESF form.** WEFO has addressed complaints about the amount of information required from applicants by replacing the application form for ERDF, EAGGF and FIFG with a shorter form that asks for key factual information, supplemented by a project plan with the substantial justification for the project. WEFO will not replace the ESF application form because it is integrated into the ESF

database in use in England, although the form is unpopular with applicants and was criticised in the independent evaluation of the programmes carried out at their mid-point (the "mid-term evaluations" required by the European Commission).

10 **Project appraisal times have declined since 2000 but remain well above WEFO's target of processing fully prepared applications within 90 days.** Average appraisal times have fallen substantially as the initial backlog has cleared; WEFO took an average of 14 months to appraise applications received in 2000, compared with five and a half months for projects received in the first half of 2003. However, less than 15 per cent of appraisals meet WEFO's target of 90 days for a fully prepared application. WEFO has decided to retain this target, believing that it is attainable if WEFO is closely involved in the preparation of the application and coordinates appraisal tasks skilfully.

11 **WEFO has greatly improved the guidance available to its project appraisal officers but the reasons for important judgements are still not always fully documented.** WEFO has introduced comprehensive guidance for its appraisal staff that addresses the weaknesses identified in our 2002 report and the mid-term evaluation was generally content with the standard of project appraisal. However, there remains scope for improvement in the way that WEFO appraises the more subjective issues like added value and value for money, and WEFO accepts that the reasons for key decisions and judgements need to be better documented.

Helping to deliver what is promised

12 **WEFO has established sound financial controls and is developing them further to meet the needs of the programme.** WEFO pays grants based on self-certified claims and relies on annual external audits of project expenditure for assurance that these claims are correct. In addition, European regulations require WEFO to undertake its own, more detailed financial control inspections on a sample basis. At the time of our 2002 report, these visits had not yet begun for the current programmes as WEFO was still inspecting projects from the 1994-99 programmes. Our report and the Audit Committee raised several issues:

- there were inconsistencies in the scope of work that project auditors were asked to undertake and in the guidance provided to auditors. These inconsistencies remain because WEFO has not completed a review of the three sets of instructions to auditors that currently exist;
- the delays in starting the financial control visits for the current programmes. WEFO has begun work on the current programmes and has met targets for the amount of expenditure covered by the inspections; and
- a more general concern that projects were not being visited at an early stage to review progress and to ensure that any problems were identified and resolved as quickly as possible. WEFO is now establishing a team of twelve officials to visit ten per cent of projects each year, selected on the basis of a risk assessment.

13 At present WEFO does not monitor formally the results of the various control mechanisms, although it plans to do so. The various controls also overlap to some extent - the project audits and financial control inspections include many of the same procedures, and it may be possible to rationalise the scope and frequency of the project audits, subject to compliance with European Commission regulations.

14 **WEFO monitors the programmes effectively and now plans to verify data on a selective basis.** WEFO uses its management information system to monitor the activities and results of the European programmes under its control, and the system of targets and monitoring has been broadly endorsed by the mid-term evaluations. There are some doubts about the quality of the data submitted by project sponsors; WEFO plans to examine this problem as part of a wider evaluation of the impact of the programmes, and to review data collection systems as part of its project monitoring and control visits.

Keeping the money

15 At around the half way stage of the programmes, the European Union made available a "Performance Reserve" of additional funds for those programmes that met certain criteria (an opportunity to gain financially). And, while the amount of Structural Funding for each programme is agreed at the start of the seven-year period, the funds need to be spent in accordance with agreed profiles or the unspent balance is withdrawn or "decommitted" (a risk of financial loss).

16 **Wales met the targets necessary to earn the Performance Reserve.** The European Commission announced in March 2004 that Wales would qualify for the Performance Reserve for each of the three main programmes (Objectives 1, 2 and 3). This adds four per cent or £65 million to the total programme budget for the 2000-06 period, and does not require any additional match funding. To qualify, Wales had to fulfil at least 75 per cent of the criteria within each of three categories: effectiveness (the activities and results of the programmes), management (the quality of WEFO's management of the Funds) and financial (enough spending and private sector match funding). The Commission placed particular emphasis on achievement of the financial and management criteria.

17 **WEFO met all of its decommitment targets for 2003 but relied on special measures to help achieve them.** WEFO met all its December 2003 targets for spending against profile, some by a comfortable margin, but achieving them proved to be exceptionally challenging - some were met only in December and represented the culmination of an intensive effort to generate additional spending, such as £34 million from retrospective grants (approved after the expenditure had occurred) and £9 million from expenditure that was created by raising grant rates on existing projects. WEFO also brought forward expenditure by requesting projects that normally claimed grant every quarter to submit monthly claims for October and November 2003. If WEFO had not taken these special measures to increase expenditure, Wales would have lost £105 million - £40 million from decommitment and a further £65 million in Performance Reserve funding, which depended on WEFO meeting its spending targets.

18 Several factors contributed to the difficulties faced by WEFO in achieving the spending targets:

- a sharp decline in the £/€ exchange rate in early 2003 which increased the spending target (had the previous exchange rate continued to apply, WEFO would have met most of its targets without the need for special measures);
- long delays in receiving grant claims - especially from public sector bodies;
- a chronic problem of projects spending less than they forecast; and
- shortfalls in project approvals in some parts of the programmes, meaning that expenditure will also be delayed. The Assembly Government is now working to develop large, all-Wales projects specifically to fill these gaps in the programme.

Notwithstanding these factors, WEFO and the Assembly Government remain confident about their ability to meet the decommitment targets each year for the remainder of the programmes.

19 **WEFO has a sound funding strategy to help ensure that the Structural Funds are fully spent by the end of the programming period.** WEFO plans to ensure that the Structural Funds are fully spent by the end of the programmes by forward commitment (approving grant at a faster rate than originally planned to reduce the risk of decommitment), over-programming (committing more money than is actually available, on the basis that some of it will never be needed because projects under-spend), co-financing (using the Structural Funds to expand or create large schemes that will help fill gaps and ease the management of the programmes) and using retrospective projects to meet any residual shortfalls. This strategy reflects WEFO's recent experience and is appropriate in its current position.

The Big Picture

WEFO has addressed many of the issues raised in our 2002 report and by the Audit Committee later that year. Some of the Audit Committee's recommendations have yet to be fully implemented, but WEFO tackled those issues of greatest risk first. WEFO and its partners have come through the mid-term evaluation and review successfully, managing to secure the Performance Reserve and to meet all of the spending targets despite the delayed approval and slow progress of many projects. These are considerable achievements. Nevertheless, serious challenges remain and there is more for WEFO to do. In particular, Wales only just avoided decommitment and qualified for the Performance Reserve; success - worth a total of £105 million to Wales - depended on WEFO invoking special measures to generate expenditure. The scope for such action will diminish as the programmes progress and the easiest options are taken. Given the range of factors potentially affecting WEFO's ability to meet its decommitment targets, the risk of decommitment - the loss of money for Wales - remains a very real one for 2004 and beyond. Finally, WEFO needs to prepare in good time for the next programming round, when Wales is likely to receive substantial transitional Objective 1 funding, so that the problems that afflicted the start of the current programmes do not happen again. The Assembly Government is alert to these challenges and has plans to meet them.

1 Introduction

1.1 In response to the widespread public interest in the success of the Objective 1 Programme, we reported in June 2002 on the management of the Structural Funds in Wales[1]. The National Assembly's Audit Committee took evidence on the report and issued its own report in December 2002, which included a number of recommendations aimed at improving the management of the programmes. This report examines the progress made in implementing audit recommendations and reviews the level of programme expenditure, since under European Union rules the funding will be withdrawn ("decommitted") if it is not spent quickly enough.

1.2 The European Union's Structural Funds exist to address structural economic and social problems in order to reduce inequalities between different regions and social groups. Structural Funding is delivered through seven-year programmes that are developed by the relevant authorities in member states and agreed with the European Commission. The current programming period runs from 1 January 2000 to 31 December 2006.

1.3 Wales is benefiting from a major increase in Structural Funding compared with previous programmes: £1.5 billion[2] is available for commitment during the current period. This is supplemented by £1.75 billion from the UK public and private sectors, known as match funding, which may come from existing expenditure. The reason for this increase is that West Wales and the Valleys (which covers about 63 per cent of Wales' population) qualifies for Objective 1 funding, which is directed at the poorest regions of the European Union. The Objective 1 Programme for West Wales and the Valleys accounts for 84 per cent of the total funds available, the rest being distributed across six much smaller programmes **(Figure 1)**.

1.4 The Structural Funds are administered in Wales by the Welsh European Funding Office (WEFO), part of the Welsh Assembly Government, which is formally accountable to the European Union for managing and paying the funds in accordance with its rules. However, the concept of partnership underpins the planning and delivery of the programmes in Wales. WEFO's partners - who represent a diverse range of interests in the public, private and voluntary sectors - are heavily involved in the planning and delivery of the programmes, principally through a network of committees with specific functions. Ultimately it is the project sponsors - those who apply for grants and deliver the projects on the ground - who drive the programme and who will have the greatest influence on its success. **Figure 2 overleaf** provides some further information on how the funds work in practice and recent changes are considered in more detail in Part 3 of this report.

1.5 The programmes are now just over half way through the programming period and have recently been evaluated and reviewed in accordance with the European Commission's requirements. The mid-term evaluation is a detailed independent analysis of each programme to consider whether the strategy remains valid, examine the progress made and recommend changes for the second half of the programme. This informs the mid-term review, undertaken by WEFO as the managing authority, which assesses overall progress against targets and proposes changes for the rest of the programming period to the European Commission. As part of this process, the European Commission has decided that the programmes should benefit from the Performance Reserve, an additional sum of money allocated to those programmes that have met pre-determined targets. The European Commission also responds formally to each mid-term review, accepting or rejecting any changes proposed.

1 *Report by the Auditor General for Wales European Union Structural Funds: Maximising the Benefits for Wales, presented to the National Assembly 13 June 2002.*

2 *Based on a rate of £1.00 = €1.40, which was the rate used by WEFO for planning purposes at the time this report was published. The rate may alter in the future if the exchange rate alters significantly from this figure.*

1 Mechanisms for distributing the Structural Funds in Wales

Figures exclude the Innovation Funds and the Rural Development Plan. Amounts shown are based on planning rate of £1 = €1.40, adjusted for actual exchange rates for payments already made.

The Structural Funds	Grant available £m	% of total grant
European Regional Development Fund (ERDF)	904	59.2
European Social Fund (ESF)	510	33.4
European Agricultural Guidance and Guarantee Fund (EAGGF)	102	6.7
Financial Instrument for Fisheries Guidance (FIFG)	11	0.7
Total	**1,527**	**100.0**

Where the Funds will be spent:	Grant available £m	Grant rate (%)	Match-funding £m	Total £m
Objective 1 (West Wales and the Valleys)	1,282	47	1,447	2,729
Objective 2 (parts of East Wales)	86	40	131	217
Objective 3 (East Wales)	92	42	129	221
Total for Objectives	**1,460**	**46**	**1,707**	**3,167**
EQUAL (all of Wales)	15	50	15	30
INTERREG IIIa (West Wales)	34	73	13	47*
LEADER+ (rural Wales)	10	48	11	21
URBAN II (Wrexham)	8	50	8	16
Total for Community Initiatives	**67**	**59**	**47**	**114**
Total for Structural Funds	**1,527**	**47**	**1,754**	**3,281**

NOTE

* This is the total for the joint Ireland/Wales programme.

Source: WEFO

Scope of the study

1.6 In considering the progress made by WEFO in implementing audit recommendations, we have clustered the relevant issues in the context of four important aspects of its management of the current Structural Fund programmes:

- **supporting the process** through adequate staff resources and sound information systems;
- **getting the right projects** by helping applicants to find match funding, engaging the private sector, making access to the Funds as simple as possible and appraising projects rigorously;

2 Key players in the management of the Structural Funds

Welsh European Funding Office (WEFO)

WEFO is the designated managing authority (accountable to the European Union for the efficiency and correctness of programme management) and the paying authority (accountable for paying the grants, obtaining reimbursement from the Commission and ensuring adherence to the European regulations governing the expenditure). Its main responsibilities include:

- co-ordinating the development of strategy;
- appraising project applications and selecting projects based on the programme strategy and the European Union's regulations;
- issuing contracts, paying grants and obtaining reimbursement from the Commission;
- financial control of the programmes, ensuring that projects deliver what they promise and adhere to regulations;
- monitoring the progress of the programmes and organising evaluations at the middle and end of each programme; and
- assisting the Programme Monitoring Committees and the local partnerships by providing information and consulting them when appropriate.

Programme Monitoring Committees (7)

Each programme is supervised by a Programme Monitoring Committee, with members drawn equally from the public, voluntary and social sectors. The PMC makes key decisions, reviews the progress of the programme and monitors expenditure, activity and outcomes. It is responsible for the strategic direction of the programme and approves key documents including the single programming document (the strategic plan), the programme complement (the operational plan), and subsidiary strategies produced by local partnerships and other groups. It also approves the mid-term evaluation and mid-term review.

Local partnerships (28 for Objectives 1, 2 and 3)

The main programmes have a committee for each local authority area covered by the programme, with members drawn equally from the public, voluntary and social sectors. The local partnerships are responsible for developing a local strategy in line with the overall programme strategy, monitoring its implementation and helping to develop projects that meet its aims. They also promote the programme locally, develop links with the local authority's wider plans and have now acquired responsibility for supporting projects after they have been approved.

Thematic Advisory Groups (six for Objective 1)

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

Project sponsors

Project sponsors are organisations that develop project ideas, submit them to WEFO and deliver them if they are approved. They are responsible for implementing the project in accordance with a contract that specifies a timescale, spending profile and performance targets. The sponsor must abide by European regulations and meet demanding requirements for record-keeping, accounting and financial control.

Most project sponsors are large public sector organisations that have been active in the field of economic development, education and community regeneration for many years. These include local authorities, the Welsh Development Agency, ELWa and colleges of further and higher education. However, voluntary organisations and private companies are also encouraged to sponsor projects and many have done so, often on a smaller scale than public sector projects.

- **helping to deliver what is promised** by providing efficient monitoring and control arrangements that offer support to projects whilst ensuring that they comply with the rules; and
- **using all the money available** by ensuring that Wales avoids decommitment and benefits from the Performance Reserve.

1.7 This report is an overview of progress since our last report, and is not an in-depth investigation of either the management or the impact of the Structural Funds. We have drawn wherever possible on the work of others, and have focused on the areas of concern identified in the reports of the Auditor General and the Audit Committee. Since the bulk of the current round of funding is directed at Objective 1, we have focused our attention for the most part on that programme. In summary, we have:

- reviewed WEFO's operational plan, management information and procedures;
- reviewed the papers of the Programme Monitoring Committees and other partnership groups where appropriate;
- discussed the main issues with key staff in WEFO;
- examined the results of mid-term evaluations of the main programmes, internal audit work and the work of WEFO's financial control team. We also took account of the National Audit Office Wales' own external audit work on both WEFO and some Structural Fund projects.

Appendix 1 lists the recommendations made by the Audit Committee, the response of the Welsh Assembly Government and a note on the current position, together with a reference to where the issue is covered in this report.

2 Supporting the Process

2.1 WEFO needs adequate resources - in the form of trained staff and good information systems - in order to manage the programmes effectively. This part of the report considers the progress made in improving the staffing position and WEFO's management information systems.

WEFO has enough staff to fulfil its functions but vacancies in some areas have created particular pressure

2.2 WEFO grew rapidly in its first two years as the programmes got underway, and had difficulty in recruiting the right number of staff with the skills it needed. Although WEFO has an approved complement within the Assembly, WEFO told the Audit Committee that not all posts might be needed all the time. Thus at the time of the Audit Committee's hearing in June 2002, WEFO had 157 people in post against a total complement of 180; however ten of these posts were not needed immediately as the volume of payments had not built up to the level originally expected. The remaining vacancies were spread throughout the organisation and WEFO did not view them as a serious problem. This contrasted with the situation a few months previously when much higher vacancy levels had caused problems, as we had reported. The Audit Committee was particularly keen to ensure that such problems did not recur and emphasised that a shortage of staff must not be allowed to have any detrimental impact on the management of the programmes.

2.3 Between June 2002 and December 2003 the total complement rose from 180 to 208 full time posts. Excluding those posts which WEFO considered did not require to be filled immediately, the vacancy rate remained relatively stable at between six per cent and eight per cent for fully operational areas of the business. There is no evidence that this has had a significant adverse impact on WEFO, although there have been pressure points where particular shortfalls have persisted. These are most acute in smaller and more specialist units like the Research Monitoring and Evaluation team, where a small number of vacancies can have a significant effect and it is more difficult to replace and train staff quickly. WEFO has succeeded in delivering its core services despite these vacancies, managing the additional workload by re-prioritising non-urgent tasks and spreading the remaining additional workload amongst the remaining staff across WEFO.

2.4 A recurrent problem for WEFO has been a high level of internal staff turnover as employees may apply for transfers to any other division within the Assembly, and the number of opportunities has risen as the Assembly's staff numbers have increased. The recruitment process tends to be time-consuming - particularly where external recruitment is necessary - which can lead to a significant interlude while the resulting vacancies are filled. WEFO has regular meetings to review the staffing position and the position has improved significantly recently. Nevertheless, these factors mean that it can take several months fully to establish entirely new teams, such as the project monitoring team established in early 2004.

WEFO has made progress in developing its management information systems but further improvements are necessary

2.5 WEFO inherited a series of disjointed systems that were not fit for purpose; they were not designed for the current programmes and were not integrated with each other. Management information was severely limited: for example, information on outputs was not recorded for funds other than the ESF, and many potentially useful management reports could not be collated. There was also a heavy demand on claimants (who had to complete details of previous grant claims and expenditure every time they submitted a claim) and on WEFO staff (who had to process claims manually and double-enter data on various systems and spreadsheets).

2.6 To address these issues, WEFO planned a two-stage approach to integrate its management systems:

- developing an Integrated Grant Payment System (IGPS) by updating, enhancing and integrating the grant approval and payments systems for all funds other than the ESF (for ESF projects, WEFO shares a separate system that is overseen by the Department for Work and Pensions); and
- developing a Grant Management Information System (GMIS) that would link the IGPS with the existing ESF system to provide comprehensive management information reports for all the Structural Funds and Community Initiatives.

2.7 Both of these projects were planned for completion in mid-2002. In the longer term WEFO intended to enhance the system so that grant applications and payments could be made through its website, with potential savings for both WEFO and project sponsors. The Audit Committee was keen to see these improvements come to fruition as soon as possible.

2.8 Both projects are substantially complete and are functioning effectively. The IGPS was completed in September 2002, some four months later than the original plan due to programming problems and delays in entering data on the system - primarily due to staff shortages and delays in agreeing amended project output targets with sponsors. The Grant Management Information System was delayed by about eight months by software problems and delays in completing the linked IGPS project. However, it is now in place and is able to generate a wide range of management reports that meets most of WEFO's needs **(Figure 3)**. It also provides the partnerships with detailed information about activity in their area of business which was not previously available, including the facility to analyse outputs by local authority area so that the geographical distribution of the programme's benefits can be tracked.

2.9 The two systems have largely delivered the expected benefits of a more efficient claims process and improved management information, and the system continues to develop in this respect. The claims process is more efficient because a lot of information on previous claims and current targets is automatically printed on the claim form before it is sent to applicants, reducing the time they have to spend completing it. And there are several automated controls in the system to validate the data entered and

3 Improvements to management information with WEFO's enhanced IT system

The new system allows WEFO and its partners to obtain a lot of useful information that was previously unavailable or difficult to collate accurately and quickly. For example, users can:

- Analyse expenditure and outputs according to EU coding requirements
- List overdue late grant claims for action by WEFO staff
- Forecast expenditure based on spending forecasts provided by project sponsors - a particularly important need in fighting the threat of decommitment
- Review match funding by programme, fund and type of project sponsor
- Analyse outputs predicted and achieved by Programme, Fund and Measure (each Objective is divided into priorities and sub-divided into Measures - 7 and 37 respectively for Objective 1)

ensure that limits on match funding and budgetary transfers are not breached, thus saving time for WEFO's staff and improving the standard of control over the data recorded on the system.

2.10 Nevertheless, there is considerable scope for further improvements to efficiency, and WEFO would like to implement several projects to enhance the current systems. In particular, WEFO has been unable fully to integrate the ESF database into the Grant Management Information System since the ESF system does not record sufficient detail on outputs. Consequently this monitoring information must be collected separately from project sponsors and entered manually by WEFO staff, a time-consuming exercise that currently occupies two full-time clerical staff.

2.11 WEFO has outline plans to enhance the ESF system and to develop the whole system so that grant and payment applications may be made over the Internet. If successfully implemented, this has the potential to deliver major efficiency savings by eliminating the need for manual completion of forms and data entry by WEFO's payments staff. The number of standard checks that WEFO undertakes could be significantly reduced by incorporating automated controls into the system, which would also reduce the number of minor queries on forms that need to be returned to project sponsors. Although it has not conducted a full cost-benefit analysis, WEFO believes that the current system could be enhanced to provide this capacity within a reasonably short period.

2.12 Under the new Merlin framework for its information and communications technology (the successor to the Osiris system, on which the Auditor General for Wales reported in October 2002), the Assembly is looking to rationalise its IT arrangements and is exploring the scope for efficiency savings; there are several hundred project proposals which are currently being evaluated. There are plans for a fully integrated, web-enabled IT system for the Structural Funds to be a priority under these arrangements so that it can be implemented in time for the new round of programmes in January 2007. It may also be possible to include residual transactions from the current round of programmes on the new system, since these will run on until 2009.

KEY POINTS ON SUPPORTING THE PROCESS

- WEFO has increased its complement of staff, but there is a vacancy rate of six to eight per cent in fully operational areas of the business. This has not had a significant adverse impact on WEFO's ability to deliver its core services although it has, for example, contributed to the delays in implementing new IT systems.
- WEFO's staff may transfer to other parts of the Assembly with relative ease, and it can take a long time to recruit and train new people.
- WEFO has made good progress in implementing a new management information system, which has largely delivered the expected benefits: much better management information and more efficient administration.
- There has been little progress towards a web-enabled system, which would let project sponsors apply and claim over the Internet. This would bring major benefits in terms of efficiency and convenience, but is unlikely to happen until 2007. The Assembly is developing all IT projects within its new Merlin framework; within this a new IT system for WEFO is seen as a priority project.

Getting the right projects 3

3.1 The development of sound project proposals, which meet the strategic aims of the programmes and comply with European regulations, is fundamental to the success of the Structural Funds. Potential project sponsors need help from WEFO and its partners to develop project ideas into robust proposals that are selected to receive grants. In the early days of the current programmes, uncertainties and delays about these aspects of the process caused considerable frustration among partnerships and project sponsors. This part of the report considers the progress made in meeting the needs of project sponsors in terms of securing match funding, engaging the private sector, reducing project appraisal times, streamlining the relevant process and improving the rigour of project appraisal practices.

The amount of match funding has not constrained the programmes so far, but tighter budgetary management will be necessary to ensure that this remains the case

3.2 The European Union contributes towards the overall cost of each programme, but money must come from domestic resources in the public, private or voluntary sectors. On average, the Structural Funds will provide 47 per cent of the planned total finance for the programmes in Wales, although this varies significantly between and within programmes. Current plans require match funding of £1.75 billion to be available for the period to the end of 2006, of which £1.20 billion (70 per cent) is expected to come from the public sector and £548 million (30 per cent) from the private sector. Finance is available from a wide range of sources; project sponsors may use their own core funding to match the cost of European projects, and they may also count as match funding the value of in-kind contributions, such as volunteer labour.

3.3 Each project must secure its own match funding before WEFO approves a Structural Funds grant. Match funding is the responsibility of the project sponsor and WEFO does not provide match funding in its own right, although it does provide advice on sources of finance and administers the Local Regeneration Fund for local authorities as part of the Assembly Government.

3.4 Clearly it is vital that sufficient match funding is available for projects. The Audit Committee recognised WEFO's limited role in the provision of match funding, but in view of the issue's importance it recommended that WEFO be as proactive as possible in monitoring the availability and take-up of match funding so that problems - and potential solutions - could be identified by those who had the necessary influence to deliver improvements. This was particularly important as problems could manifest themselves in a lack of projects coming forward, rather than more easily identifiable problems with project proposals that already existed. The Committee was also keen to ensure that comprehensive information and advice was available to applicants, as this had been deficient in the early stages of the programmes.

3.5 WEFO's new management information system can analyse the origin and amount of match funding down to the project level. WEFO uses this information to report regularly on the relative contribution made by the Structural Funds for each Measure, for both grant approved and grant paid. At 31 December 2003, this showed that grant rates (the proportion of projects' funding from the Structural Funds) were generally below those planned, indicating that the overall availability of match funding for grants approved had not been a major problem to that date. None of the mid-term evaluations reported any significant problems in the amount of match funding available.

3.6 Other than this, WEFO does not specifically and routinely monitor the availability and take-up of match funding at a programme level, but has assisted others to assess specific issues as and when they arise. This targeted approach is appropriate as match funding pressures are likely to occur in certain areas, and need to be addressed at certain times - notably during the budgetary planning round for centrally-funded public sector sources of match funding. As part of this process Assembly Government officials consider the extent to which existing budgets may be used to match fund European projects, and the action to take in response to possible shortfalls.

3.7 The Assembly Government established in 2001 a number of budget lines specifically for match funding, totalling £207 million for the three years to 31 March 2004 and accounting for 29 per cent of the total public sector match funding requirement for the first three years of the programmes (at the original exchange rate of £1 = €1.62). Since then, the match funding position has tightened considerably for several reasons: slower increases in the Assembly's overall budget than in previous years, an increase of £30 million per year in the overall match funding requirement (to cover the likely increase in the Structural Funding available to Wales as a result of the lower planning exchange rate of £1:€1.40), and a bunching-up of projects over the next two to three years due to earlier delays in bringing projects on stream. WEFO has assisted other Assembly Government officials in monitoring and forecasting demand for the match funding budgets, and has worked with the local authorities in planning future budgetary allocations for the Local Regeneration Fund **(see Box A)**.

3.8 The risk of insufficient match funding is perhaps greatest for the voluntary sector, as it is characterised by small organisations with few resources. Progress in the community economic regeneration Measures, which depend most on the engagement of the voluntary sector, has been slower than other areas of the programmes. The Wales Council for Voluntary Action issued a report in June 2003, *The Voluntary Sector and Objective 1 in Wales,* which considered the main factors affecting the engagement of the voluntary sector in the programme. The report recommended new efforts to increase and rationalise the use of key funds, raise awareness, improve the expertise available to the sector and ease the administrative burden on applicants; it found that the Assembly Government's Communities First programme was a more popular source of finance for voluntary bodies as it was

A Pathway to Prosperity (P2P) and the Local Regeneration Fund (LRF)

These are the main budgets allocated specifically for match funding by the Assembly Government, and demonstrate recent trends in the financial position of the Structural Funds: a slow start and a recent surge in demand.

Both budgets are intended to provide "funding of last resort" for projects that cannot find other sources of finance; the Local Regeneration Fund is allocated to local authorities for capital projects, while P2P is available to the Assembly-Sponsored Public Bodies, the private sector and enterprise agencies. Delays in the development appraisal and delivery of projects meant that payments in the first two years - to 31 March 2003 - were much lower than expected. LRF payments were just £9.5 million compared with the £60 million expected, largely due to slippage in the delivery of approved projects. The Assembly Government has discussed the financial position with local authorities and has agreed to carry forward substantial sums of money to 2004-05; expenditure is now forecast to rise sharply to £102 million over the three financial years to 2007.

Demand for P2P increased rapidly in 2003-04, and a backlog of applications built up while the Assembly Government prioritised applications. Officials told us that an expectation had apparently developed that P2P was easy to obtain and could be used as a source of mainstream funding, when this had never been intended. Although the criteria for approval of P2P have not changed, officials have applied them more strictly and this has resulted in the withdrawal of some projects. Project sponsors are now encouraged to maximise the use of their core funding (and to use this as match funding instead of P2P if possible) and of the Structural Funds; this reduced the demand on P2P and helps WEFO meet its spending targets. The backlog of projects has been largely cleared and the Assembly Government is confident that demands for P2P match funding will be met from the indicative budget and, if necessary, from under-spends elsewhere in the Economic Development and Transport budget.

perceived as quicker and simpler in its administrative procedures. The availability of match funding was not considered to be a major impediment; the main issue raised was the difficulty of co-coordinating various sources of finance, especially if the timing of payments from the Structural Funds was not aligned with that from other sources.

3.9 The simplest method of providing match funding to small organisations is through key funds, whereby European grant is combined with match funding by a larger organisation, and passed on to the beneficiaries as a single funding stream. Limited progress has been made in establishing key funds for voluntary bodies; about half of the local authorities have established funds for community economic regeneration, and the Wales Council for Voluntary Action operates its own all-Wales scheme. It is now working with WEFO to establish more broadly based funds and to make them accessible for covering the cost of preparing a project, which has been identified as a constraint on project development.

3.10 The Assembly Government now has a policy of delivering the programmes more widely through the key funds principle, maximising the use of the Structural Funds to co-finance large projects and existing programmes that will deliver the programme on a regional or national basis. The Government believes that this will be a more strategic approach that will help fill gaps that have emerged in particular parts of the programme and will maximise the use of existing resources as match funding, thus conserving the specific match funding pots as the financial demands of the programme reach their peak.

Many private sector-led projects have been approved or are in the pipeline, and private sector match funding is on course to meet targets

3.11 The Assembly Government always envisaged a much greater role for the private sector in the 2000-06 programmes than the previous programming rounds, when there were few private sector-led projects. The private sector was to play a key role in the partnerships, lead projects for wider public benefit, and contribute £548 million (30 per cent of total match funding) towards the cost of the programmes.

3.12 To help it achieve these objectives, the Assembly Government:

- established the Private Sector Unit within WEFO to inform and advise the private sector on the Structural Funds, and guide potential project sponsors through the development and appraisal process;
- worked with social partners to establish the Social Partners Unit to assist partnership committee members from the social sector (which includes the private sector);
- supported the Chambers of Commerce in Wales in appointing private sector facilitators, to encourage local businesses to engage with the Structural Funds; and
- developed the concept of project commissioning, via template projects. A template project would be an outline proposal drawn up by WEFO and its partners to meet strategic needs and gaps in provision. The private sector would then be invited to submit detailed proposals for delivery against the template. This would make the process clearer for applicants as major issues would have been addressed before the project was put to the market.

The Audit Committee supported these measures but expressed concern about the slow progress in approving private sector-led projects (22 at the end of March 2002) and in appointing the private sector facilitators.

3.13 Since then, considerable progress has been made in extending the support available to the private sector and in approving and developing projects. The private sector facilitators were all appointed by February 2003 and have exceeded targets to raise awareness of the programmes. The project has set itself a target to raise the turnover of local businesses by a total of £3.4 million over the three years of the project; this will take longer to achieve and measure. The facilitators have found that their work is most beneficial in promoting existing European-funded projects, which are often more appropriate sources of help for smaller businesses, than in developing new projects. Nevertheless, the facilitators have been able to bring some ideas for new projects to the attention of the Private Sector Unit, which is better placed to liaise with those who can develop them into viable proposals.

3.14 There has been substantial progress in approving private sector-led projects, with many more under appraisal or at various stages of development **(Figure 4)**. At 31 March 2004, a total of £427 million of private sector finance had been obtained, representing 35 per cent of total match funding committed and ahead of the 30 per cent target. Much of this investment will occur in projects that are led by public sector agencies but assist private businesses, for example business grant and loan schemes.

3.15 Slower progress has been made with the template projects. WEFO has agreed a procedure for developing and approving such projects, which involves thorough consultation and review to ensure that the project specification is sound. A pilot project to develop a data management service for small businesses was developed in 2003 and WEFO expects to issue a project specification in mid-2004. There are several other projects in earlier stages of development, and WEFO hopes to develop some eight projects by 2005.

3.16 The experience to date, however, is that extensive preparatory work is necessary and the overall procedure is not inherently shorter than the normal project development and approval process. While the template projects will not quickly increase the degree of private sector participation in the programme, they do offer considerable longer-term potential for widening participation, meeting specific needs that would be difficult to meet in other ways, and enhancing the quality of projects through careful research and competition. It will be several years before the success of the template projects in meeting these objectives can be fully assessed.

WEFO has kept the project appraisal process under review and has simplified the system for Objective 1, but this will not necessarily lead to a reduction in appraisal times

3.17 Each programme has its own systems for project appraisal, but most projects are funded under the Objective 1 Programme. At the time of our earlier report, this involved an eleven-stage process which typically took several months to go through. We found then that the length and complexity of the project development and appraisal process was one of the most frustrating aspects of the Structural Funds for applicants and one which they most wanted to be addressed. The Audit Committee recognised that progress was being made and that there would always be a degree of tension between having a user-friendly process, and one that provided the necessary rigour to ensure that the funds were properly spent. Nevertheless, the Committee remained concerned about the "laborious and

4 Private sector-led projects: position at 31 March 2004

Stage	Number of projects	Grant (£m)	Total cost of project (£m)
Projects approved	141	57	147
Projects under appraisal (formal application received by WEFO)	70	43	112
Projects under development (no application yet received by WEFO)	56	10	74

NOTE

Grant and total cost figures are estimated for projects under development, and in some cases no figures have yet been provided. Figures include INTERREG projects, which take place in Ireland as well as Wales.

Source: WEFO

lengthy process" and considered that it could "only be justified if each element demonstrably adds value to the process." It recommended that WEFO keep the process under review, with a view to removing or amending those elements that became superfluous. Further recommendations in this area related to the way that WEFO went about appraising projects.

WEFO has streamlined the application and appraisal process for Objective 1

3.18 When WEFO came to review the application and appraisal process, it concluded that the culture of partnership was now well established and that the emphasis on formal committee structures and consultation processes could be reduced. In June 2003, the Programme Monitoring Committee accepted WEFO's recommendations for reforming the structure and process, and the following key changes took effect from 1 January 2004:

- the ten regional and four strategy partnerships have been abolished and replaced by six thematic advisory groups (TAGs), selected for their expertise to provide WEFO with specialist advice on projects and strategy;
- the 15 local partnerships remain but focus more on wider economic development issues in their areas, and on providing post-approval assistance to projects ("aftercare");
- most projects no longer have to be submitted through partnerships, although sponsors are encouraged to seek their advice and assistance where appropriate; and
- the consultation process has been streamlined so that the views of partnerships are sought by WEFO at appraisal stage, at the same time as advice is sought from specialists and the thematic advisory groups.

The revised process is set out and compared with the previous process in **Figure 5**.

3.19 These changes have created a more flexible system that has eliminated or combined several stages of formal project assessment. WEFO hopes to improve further its coordination of tasks during the appraisal process so that advice is sought at the same time from partnerships, thematic advisory groups and specialist advisors. This is key to reducing the length of the appraisal process, since the amount of work required has not changed significantly.

3.20 Another key to reducing the length of the appraisal process is to ensure that project sponsors develop good quality applications that can be appraised quickly. This requires good communications between sponsors, partnerships and WEFO so that the applicant is aware of WEFO's requirements and potential problems can be resolved at an early stage. WEFO plans to increase its involvement at the project development stage, offering advice as required and consulting thematic advisory groups if necessary to offer appropriate direction to the sponsor. WEFO has appointed officers to act as contact points and advisers for each Measure in the Objective 1 Programme, and intends to develop its involvement in project development throughout 2004.

WEFO has improved the Objective 1 application form for ERDF, EAGGF and FIFG, but there are no plans to replace the problematic ESF form

3.21 WEFO has streamlined the application form for ERDF, EAGGF and FIFG in response to concern from applicants about the amount and complexity of information requested in the previous application form. In England, Objective 1 applicants complete a shorter form with key factual information, and submit a business plan which provides the substantial justification for the project. Whilst there were some disadvantages to this approach, we recommended that WEFO consider adopting the English approach as a business plan would give applicants more discretion to present their project, and hence give WEFO a better idea of how well developed the project idea actually was.

5 The project development and appraisal process

<table>
<tr><th>Stage</th><th>Old process (until 31 December 2003)</th><th>New process (changes from 1 January 2004)</th></tr>
<tr><td>1</td><td>Applicant approaches the relevant partnership to discuss a project idea</td><td>Applicant is directed (eg by WEFO) to the appropriate supporting body - usually WEFO's private sector unit, a local partnership, Assembly-sponsored public body or the Wales Council for Voluntary Action</td></tr>
<tr><td>2</td><td>Partnership assists the applicant to develop the idea and prepare a pro-forma application</td><td>Supporting body assists the applicant to develop the idea and prepare a full application</td></tr>
<tr><td>3</td><td>This proforma is considered by a sub-group of the partnership board</td><td rowspan="5">Projects proceed straight to appraisal[1], although there is the option to consult local partnerships and other organisations at this stage</td></tr>
<tr><td>4</td><td>Details on the pro-forma are circulated to other interested partnerships</td></tr>
<tr><td>5</td><td>The proposal, revised as necessary, is submitted to the full partnership board</td></tr>
<tr><td>6</td><td>Partnership board helps the applicant to complete a full application form</td></tr>
<tr><td>7</td><td>Partnership submits the application form to WEFO, indicating its support for the project</td></tr>
<tr><td>8</td><td>WEFO appraises the project, ensuring confirmation of eligibility and that it provides value for money, seeking external advice as necessary</td><td rowspan="3">WEFO appraises in the same way as before, except that:
local partnerships are consulted at this stage[1]
thematic advisory groups have replaced the strategy partnerships, but they have the same role in terms of project appraisal
the views of the local partnerships, thematic advisory groups and specialists are sought at the same time</td></tr>
<tr><td>9</td><td>WEFO recommends approval or rejection to the strategy partnership (also copied to other partnerships who commented previously on the proposal)</td></tr>
<tr><td>10</td><td>Strategy partnership carries out a qualitative assessment on how well the project contributes to the overall strategy, recommending approval or rejection, or requesting further information</td></tr>
<tr><td>11</td><td>WEFO issues, where appropriate, a formal offer of grant to the applicant</td><td>No change</td></tr>
</table>

NOTE

1 Projects under those Measures for which the local partnership has a financial allocation are referred to the partnership board at the development stage, before passing to WEFO for appraisal.

3.22 WEFO accepted this recommendation and a new application form has been used since August 2003. The form is much shorter, focuses on important factual information and asks for less information on project costs. The project plan requires a more substantial justification for the project and in some respects asks for more specific information than before about the need for the project and how it will be managed, delivered and marketed. The cost tables have been automated so that totals and grant rates are calculated automatically. The language and terminology have been simplified, information requirements have been consolidated and omissions have been dealt with - for example, applicants now have to assess the main risks facing their project and explain how they will be managed. Although there is no overall reduction in the amount of information requested, these changes have made the form easier to understand and to complete, and it now contains all the necessary information for a rigorous appraisal of the project.

3.23 There has been no change to the ESF application form. WEFO continues to use the fully computerised version that is used in England. The mid-term evaluations for the Objective 1 and Objective 3 programmes reported two major concerns with this arrangement:

- most applicants interviewed by the evaluators found the form to be burdensome, in that it "invited repetition, encouraged applicants to make tenuous links between projects and strategy documents and ultimately made turgid reading"; and
- the current form asks for extensive information about beneficiaries - much of which is very difficult to estimate accurately - but it does not allow the collection of data that is actually needed to monitor the programme, necessitating a system of additional monitoring returns.

3.24 Both of the relevant mid-term evaluations recommended that WEFO consider adopting a new application form and guidance pack for ESF applicants, following the principles for the new Objective 1 application form for the other Funds which commands more support among project sponsors. However, WEFO has decided not replace the form. It considers it more practical to retain the current form, which is familiar to project applicants and is integrated with the current ESF database, whereas a new form would be largely manual in the absence of a web-enabled system covering all the programmes.

Project appraisal times have declined since 2000 but they remain well above WEFO's target of processing fully prepared applications within 90 days

3.25 The sheer length of the Objective 1 appraisal process was a major concern expressed by applicants when we first reported on the Structural Funds in 2002. This was due largely to the long delays that occurred in the first year of the programme when more than 600 projects were submitted at the same time, many of which needed substantial further work before WEFO would approve them. The situation subsequently improved as the various parties involved gained a better understanding of what was needed, and fixed deadlines for the submission of applications were largely removed in favour of a "rolling programme" whereby projects could be submitted at any time.

3.26 The time needed to appraise a project depends on many factors, including the complexity of the project, the amount and nature of specialist advice needed, how well prepared the application is and whether there are any major issues that need to be resolved before approval can be granted. For example, problems with state aid regulations or planning permission can delay project approval for many months. Many of the tasks involved in the appraisal process are not undertaken by WEFO and overlap with each other so that their impact on the overall appraisal time is not always clear. The Audit Committee recommended that WEFO used its new information system to monitor appraisal times systematically, so that any problems or delays could be identified quickly.

3.27 The new information system (paragraph 2.8) is not currently used to monitor appraisal times, although it is capable of providing headline figures on the total duration of the process. WEFO has established a separate "electronic diary" to record the date that 13 key appraisal tasks are started and finished. The information from this database will enable a more sophisticated analysis of appraisal times so that the impact of each task can be properly assessed. The diary has been operating since July 2003 and it will take some time to build up enough information to make informed judgements, as the whole process takes many months to complete in most cases.

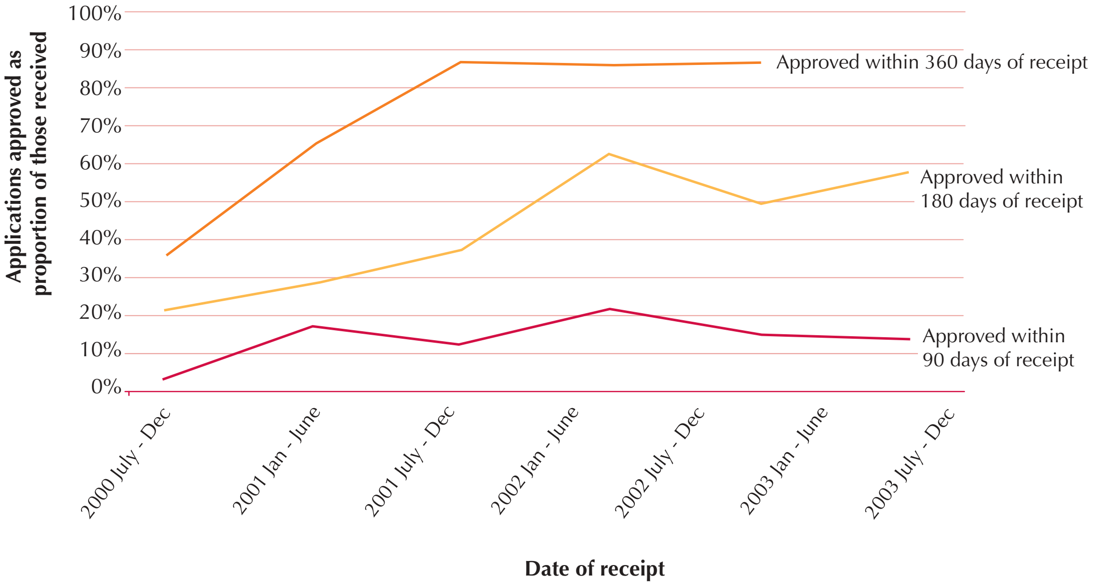
3.28 The National Audit Office Wales used data from WEFO's main information system to identify trends in overall appraisal times for projects approved under Objective 1. The results are shown in **Figure 6**:

- there has been a substantial reduction in the proportion of projects taking longer than a year to approve (from 60 per cent in 2000 to 13 per cent in 2002);
- the majority of projects are now approved within six months, a big improvement from the situation in 2000; and

6 Project appraisal times have improved, but few projects are processed within WEFO's target of 90 days for fully prepared applications

The graph measures the time between the receipt of an application in WEFO and the date that a grant approval letter is issued. It includes all projects approved under the Objective 1 Programme by 31 December 2003. Performance is measured to the latest available date (for example, data for projects approved within 90 days include all applications received on or before 30 September 2003, which is 90 days before 31 December 2003).

The scale of the graph is cumulative, so each line includes all projects processed in less than the time stated. For example, the line showing projects processed with 180 days includes those projects processed within 90 days.



Source: National Audit Office analysis of WEFO data

- WEFO has had less success in raising the number of projects approved within 90 days (its target for fully prepared applications) - performance has improved but there is no indication that WEFO is able to achieve its target in most cases.

3.29 There has therefore been a marked improvement in average appraisal times between 2000 and 2001, with slower improvement since then. Median appraisal times fell from 17.4 months in 2000 to 7.3 months in 2001 and five months in 2002, with a similar performance emerging for 2003. Appraisal times have improved across the Objective 1 Programme, with those for ESF being markedly better than those for the other Funds.

3.30 These headline figures do not permit a meaningful analysis of the reasons for delays. WEFO has investigated in more detail a sample of Objective 1 projects and identified the following characteristics:

- it has spent more time in total on specific appraisal tasks (as more advice is sought from specialists, for example) but has managed to overlap these tasks so that the total duration of the process has declined;
- with some projects, especially more recent ones, WEFO provided more support to projects before an application was sent in. This resulted in an average time saving of about three months at the appraisal stage; and
- the most time-consuming tasks are obtaining professional advice and seeking additional information and clarification from applicants - each typically takes more than 80 days to complete. In contrast, none of the tasks that are wholly under WEFO's control (for example confirming basic eligibility) takes more than 40 days and most are completed in less than ten days.

3.31 Overall, WEFO has improved its appraisal times substantially from the difficult first year of the programmes in 2000, but has improved more slowly since then. Less than 15 per cent of projects are approved within the 90 day target. However, most projects are now approved within six months, and the Objective 1 mid-term evaluation suggested that six months was a more realistic objective. WEFO wishes to retain the 90-day target, however, considering it achievable in the longer term with better preparation at the project application stage and skilful coordination of tasks at the appraisal stage. Its own work suggests that appraisal time can be substantially shortened using these techniques, but the target remains very ambitious and it would be unwise for either WEFO or the project sponsors to plan on the basis of a typical 90 day appraisal time.

WEFO has greatly improved the guidance available to its project appraisal officers but the reasons for important judgements are still not always fully documented

3.32 As the managing authority for the European programmes in Wales, WEFO is responsible for appraising each project application to ensure that it is eligible for support. Although each programme has its own appraisal framework which may vary by Fund and Measure, in most cases to qualify for grant the project must:

- comply with basic rules;
- be needed;
- be viable and sustainable;
- be well-managed and properly monitored;
- address the cross-cutting themes of equal opportunities, environmental sustainability and information and communication technology; and
- provide value for money.

This involves an extensive assessment of each proposal by WEFO's staff, who consult specialist advisers, local partnerships and thematic advisory groups as appropriate.

3.33 When we examined WEFO's project appraisal procedures in 2001, we found that WEFO appraised projects systematically using set selection criteria, and made thorough checks to ensure that projects were eligible for grant. However, when the programmes were launched in 2000, staff did not have adequate guidance, the process was often poorly documented and the shortcomings of many applications were not sufficiently challenged. Matters improved during 2001 as better guidance was developed and staff and applicants became more familiar with the requirements. However, many of the more difficult judgements - on added value, demand for the project and value for money - were either not properly documented or not assessed with enough rigour. Project sponsors were not asked to assess the risks facing their projects and no risk assessment was done by WEFO. The Audit Committee was particularly concerned about these problems and asked that WEFO resolve them without delay.

3.34 WEFO has now issued new guidance that provides a comprehensive and appropriate appraisal framework for staff appraising all Objective 1 projects, and which has been commended by the Objective 1 mid-term evaluation. The framework is also used in the appraisal of ESF projects, although these continue to be appraised using separate criteria and a more mechanistic scoring process than for the other Funds.

3.35 Both the mid-term evaluations and the Assembly's internal audit service have reviewed WEFO's project appraisal practices by examining a sample of projects. The evaluators were generally content with the way in which projects were appraised, although they commented on isolated examples of doubtful value for money and inconsistencies in some ESF applications. A recent Assembly internal audit of ERDF appraisals was more critical, whilst accepting that the appraisal process was well controlled and done in line with European guidelines. It reported that WEFO did not challenge important weaknesses in project applications, very few projects showed any evidence of risk assessment and the previous record of project sponsors was not consistently checked (this is an important indicator of a sponsor's capacity to deliver a project as planned). **Figure 7** sets out the main issues in this area identified in our 2002 report, how they have been addressed by WEFO in the new appraisal framework and the related findings of the mid-term evaluations and internal auditors.

7 How WEFO has addressed the issues arising from our 2002 report

Issue in 2002 report	Addressed in guidance for applicants and staff?	Improvements implemented in practice?
Added Value WEFO relied largely on the partnerships to alert it to duplication or substitution of activity. For public sector projects, it was not always clear how much additional provision was being made available with the grant or where any resources released by funding the project would be redirected. Need to: ■ focus on projects of high risk ■ ask relevant questions about previous funding, existing provision and redirection of resources. Must establish baseline position ■ ensure applicants and staff are fully aware of requirements	Most projects no longer need to be submitted through partnerships, so assessment by WEFO becomes even more important Guidance for staff now addresses the key issues and provides examples of evidence for added value. For Objective 1, ERDF/EAGGF/ FIFG application form now requires specific information on nature and amount of existing provision, so that baselines can be established	Mid-term evaluations raised no particular concerns about added value. For Objective 1, many projects claimed added value on the basis of better quality provision rather than greater quantity - this is acceptable but care needs to be taken to count only the additional benefit as an output of the Objective 1 Programme. Internal audit reports found that WEFO's assessment of added value was often poorly documented and that some projects made conflicting claims that were not questioned ESF documentation amended better to reflect the assessment of added value
Need for project Projects varied greatly in the quality of their case, and assurances rarely checked by WEFO Strong reliance on partnerships but scope and depth of assessment was not clear from documentation held by WEFO Recommendation: incorporate a more detailed assessment of project need and quality into its selection criteria for ERDF, EAGGF and FIFG, and that for all Funds the work of the partnerships in this respect be incorporated directly to minimise duplication Useful framework is to ask series of linked questions such as: what is specific need that project addresses? What other provision is there and why is this not adequate? What evidence that this project will be effective? What alternatives? How will project be promoted and beneficiaries be recruited?	Guidance for appraisal officers now provides examples of evidence to look for Appraisal guidance strengthened to address specifically the need for project outputs, project activity and project funding. Partnerships will no longer carry out their own detailed assessments but thematic advisory groups will consider the need for the project and local partnerships will still be consulted These questions are now covered in the guidance for appraisal officers and Objective 1 applicants are told to address most of these issues in their project plan or application form. However, ESF applicants are not covered by this guidance	Internal audit of Objective 1 ERDF project appraisals found that judgements on project need were often documented in a very cursory way and it was not clear from project files what evidence had been checked. Work by the partnerships was not used formally by WEFO It is too early to assess the impact of the new appraisal procedures as they have been recently introduced
Value for money Project costs usually assessed in some detail, but assessment of outcomes and unit costs was less well developed Unit costs not directly incorporated into scoring criteria for Objective 1 Scope to develop indicative unit costs and adjustments for deadweight, displacement and other factors that reduce the impact of the outputs attributed to a project	Improved guidance now available to appraisal staff, including benchmark costs for particular activities and indicative discount factors for job targets Scoring criteria have not yet been changed for any of the programmes	Increasing use made of financial appraisal and advice from Estates Division on capital projects for ERDF/EAGGF/FIFG projects External advice for ESF projects sought from partnerships and ELWa Internal Audit found little written evidence that project costs were reviewed in detail, especially unit costs and outcomes

3.36 WEFO is adamant that a detailed appraisal is carried out in all cases, but accepts that judgements on more complex value for money questions need to be better documented. The results of the appraisal are recorded on a series of detailed checklists, and for more qualitative issues like added value and the quality of management systems, the final judgement only may be recorded.

KEY POINTS ON GETTING THE RIGHT PROJECTS

On match funding

- The Assembly Government monitors the availability of match funding primarily as part of the budgetary planning round.
- There is no evidence that a lack of match funding has constrained progress to date, but pressure is increasing due to exchange rate movements, slower growth in overall spending on economic development, and the build-up of projects following delays earlier in the programmes.
- Demand for the Assembly Government's two specific match-funding budgets has increased substantially after a slow start. The Pathways to Prosperity budget was over-subscribed in 2003 but officials have acted to control demand by prioritising applications and encouraging projects to maximise the use of alternative sources of finance
- A greater use of key funds could help ease access for small voluntary organisations, who find it difficult to co-ordinate several sources of funding.

On private sector engagement with the programmes

- Good progress has been made in approving private sector-led projects and many others are in the pipeline.
- The private sector has committed £427 million in match funding by 31 March 2004, and is on course to meet the overall target for the programmes.
- Slower progress has been made in commissioning the private sector to deliver specific projects; no such "template" projects have yet been delivered, but WEFO hopes to have eight projects in place by 2005.

On project development and appraisal

- WEFO has radically simplified the project development and appraisal process, combining various stages and reducing the number of partnerships. WEFO plans to provide more guidance to applicants as they prepare project applications in order to maximise the benefits of the changes made.
- The application form for ERDF, EAGGF and FIFG has been improved but there are no plans to replace the problematic ESF form.
- Average appraisal times have fallen from 14 months to six months since 2000 and continue to improve slowly, but few projects are assessed within the 90-day target period. Better co-ordination of appraisal tasks should help cut times further, but the 90-day target remains very ambitious.
- WEFO has developed a robust framework for the appraisal of projects, issues sound guidance to staff and is making better use of external expertise. However, there is little evidence that the more complex value for money issues are properly scrutinised and WEFO accepts that better evidencing of actions is needed.

4 Helping to deliver what is promised

4.1 Once the right projects have been selected, their successful delivery depends on sound project management. This is the responsibility of the project sponsor, who has a legal obligation through the grant offer letter to deliver the project as planned. WEFO has two main functions at this stage:

- as the paying authority, it is responsible for paying grants, seeking reimbursement from the European Commission and controlling expenditure so as to comply with the strict European regulations that govern the Structural Funds. This is the **financial control function**; and
- as managing authority, it is responsible for monitoring the progress of each programme towards the objectives and targets agreed with the Commission. This involves both ongoing monitoring activity and less frequent, in-depth evaluation of the results and wider impact arising from the programme. This is the **monitoring and evaluation function**.

WEFO has established sound financial controls and is developing them further to meet the needs of the programme

4.2 Project sponsors submit claim forms regularly to WEFO reporting their expenditure and the outputs achieved by the project. WEFO pays grant based on these self-certified claim forms. We reported in 2002 that WEFO had established a hierarchy of financial controls to help ensure that the money was spent properly. These included:

- checks made on each claim form (normally received quarterly) by the relevant payments team, who investigate any discrepancies or unexpected changes;
- an independent annual audit of all projects, other than ESF projects with a total grant of less than £20,000. WEFO withholds payments if a project's audit is overdue or the results are unsatisfactory; and
- more detailed inspections of projects on a sample basis by WEFO's financial control team. The European Union requires these inspections to cover a minimum of five per cent of each programme's total eligible expenditure and issues guidance on what to check, how to check it and how to select the projects for testing.

4.3 These controls, if fully implemented, provide a sound framework for ensuring that the Structural Funds are properly spent. We reported that the checking of claims at payment stage and project audits had been enforced since the start of the current programmes, although there were some inconsistencies in the scope of work that auditors were asked to carry out. More importantly, the inspections by the financial control team had not begun for the new programmes as WEFO had not completed work on the 1994-99 programmes, for which inspections did not begin until the summer of 2000.

4.4 The Audit Committee was also concerned that WEFO focused mainly on checking expenditure after it had been incurred by project sponsors. Project audit work by the National Audit Office Wales and inspections by WEFO had revealed significant problems, mainly because project sponsors were not documenting spend adequately and were claiming for ineligible expenditure. In light of these shortcomings, the Committee favoured a more proactive approach to support projects and prevent problems occurring in the first place. It recommended that WEFO develop arrangements to ensure that projects had good systems in place from an early stage, and should consider a policy of visiting every project sponsor at least once to review general progress and verify output information. It also recommended that WEFO review its control arrangements to clarify the roles of project auditors and its own financial control team so as to minimise the overlap between them.

Inconsistencies remain in the scope of work that auditors are asked to undertake

4.5 Instructions for auditors have been issued by the Department for Work and Pensions (for ESF projects), the Audit Commission (for local authority projects in other Funds) and by WEFO itself (for other projects). When we reported on the Structural Funds in 2002, there were inconsistencies in the background information provided and in the scope of work that auditors were asked to undertake. For example, only ESF auditors were asked to confirm project revenue, only Audit Commission auditors were asked to confirm competitive procurement, and only the WEFO instructions asked auditors to review general financial controls and confirm that administrative expenditure had been restricted to 10 per cent of project costs. We recommended that WEFO review the instructions to ensure that they were consistent and comprehensive, that auditors were alerted to common risks and that sufficient background information was provided.

4.6 The ESF paying authorities in Great Britain have jointly reviewed the ESF audit requirement and have issued revised instructions, which are much clearer about the nature and extent of the work to be carried out. In particular the guidance specified minimum sample sizes and removed the requirement for auditors to confirm that the project was not already fully funded from another source - a key aspect of added value, but one which is time-consuming and difficult to ascertain. The instructions also limit the auditor's liability and provide clear guidance on areas of risk. The position on ESF is therefore greatly improved.

4.7 In contrast, WEFO has not undertaken similar reviews for the two sets of instructions on the other Funds, which means that the same inconsistencies remain in the scope of work that the auditors are asked to carry out. In particular, the instructions differ in the extent to which project outputs are covered: unlike ESF, auditors on the other schemes are not required to review systems for collating beneficiary data and project outputs are not covered at all.

The financial control team has started work on the current programmes, has improved its procedures and has met targets for the coverage of its inspections

4.8 The European Commission requires the paying authority for each programme to assess the risk of error across the range of the operations under its control, and to inspect a sample of projects based on this risk assessment. The financial control team completed its programme of inspections on the 1994-99 programmes in January 2003, but has had to undertake additional work in the context of the European Commission's review of the closure of these programmes across the United Kingdom (these issues are considered in more detail in the Auditor General for Wales' General Report for 2004, published 11 June 2004). WEFO has strengthened its procedures to ensure that projects in the current programmes are selected on the basis of perceived risk whilst ensuring that all programmes, types of project and payment periods are adequately covered.

4.9 One of the criteria for the Performance Reserve - described in more detail in Part 5 - was that by 31 December 2003, WEFO should have inspected at least five per cent of the total eligible expenditure under the programmes as at 30 June 2003. WEFO has comfortably met this target, achieving coverage of between 7.2 per cent and 11.6 per cent for the main programmes. Work is in hand to classify and collate the recommendations and to disseminate the findings of the work undertaken so far.

WEFO and the local partnerships will visit projects to review general progress, and these should give early assurance that sound management systems are in place

4.10 Other than its financial control visits, WEFO currently has little direct contact with project sponsors after approving their grants. Managing authorities in England tend to have more direct contact - in Cornwall and Merseyside, for example, there is a policy of visiting all ERDF projects in their first year. The Audit Committee asked WEFO to consider visiting every project sponsor at least once in order to review general progress and to verify that the project was delivering the outputs claimed. The Objective 1 mid-term evaluation reinforced this view by suggesting strongly that more contact was needed in order to capture projects' experience, highlight best practice and aid early identification and resolution of any problems. It recommended that the partnerships rather than WEFO should aim to visit project sponsors every year; this would distinguish the visits from the "policing and audit" functions of the WEFO team.

4.11 WEFO has now considered the issues involved and decided on a dual approach with visits by both WEFO and the local partnerships **(Figure 8)**. The partnerships will have an "aftercare" role providing advice and support to project sponsors, whilst gaining a more detailed understanding of how the projects are contributing to delivery of the local strategy. WEFO issued guidance in June 2003 about the scope and frequency of these visits.

4.12 WEFO is currently establishing a team of 12 people to carry out its own monitoring visits, which is likely to be fully operational by the summer of 2004. Progress has been delayed largely due to difficulties in recruiting staff, and the managing authorities in Scotland, Merseyside and South Yorkshire are more advanced in their programme of visits. WEFO's team will carry out some checks that are required by European regulations but are not fully covered by project auditors. Its primary role, however, will be to ensure that the sponsor has established sound management systems and is making good progress towards its objectives, and to give early warning of any problems that may jeopardise successful delivery. The visits will be short and will not involve a detailed examination of a project's records - this is

8 Project monitoring visits by WEFO and the local partnerships

	WEFO	Local partnerships
Who will undertake the visits?	WEFO project monitoring team	The secretariat of the 15 local partnerships (Objective 1 only)
How many projects will be visited?	Sample of 10 % of all projects, to cover the range of programmes and projects based on a risk assessment	All local projects at least once a year, with a phone call at least twice a year
When did the visits begin?	January 2004	Summer 2003
What wil be done?	■ Physical verification check as required by EU regulations - ie to confirm that the project itself and the activity claimed for it actually exist ■ Review measures taken by the sponsor to meet requirements on state aid, procurement, publicity and the cross-cutting themes ■ Review system for recording outputs ■ Review general progress and offer advice if required	General review of progress to answer the following questions: ■ Is the project delivering to time ■ Is the project likely to underspend? ■ Is the sponsor having difficulty in implementing the project? If so, could the partnership or WEFO help? ■ Are there outputs that are not reported to WEFO, ie in addition to the project targets? ■ Is there good practice that could de disseminated?

consistent with WEFO's desire to provide a supportive service and develop open communications with project sponsors. In addition, programme management (appraisal) teams visit some of the largest projects on a regular basis to discuss progress.

WEFO has set up the essential elements of project control but now needs to ensure that the results feed back into programme management and that work is coordinated to minimise the burden on project sponsors

4.13 WEFO has now established all the elements it needs to exercise an appropriate level of oversight over Structural Fund projects in accordance with European regulations and good practice. Some of the measures are still at an early stage of development and it will take time to assess their impact and refine procedures so that they contribute effectively to programme management, without imposing an undue burden on project sponsors.

4.14 Much depends on good risk management. WEFO has developed a robust risk model for its financial control team, which will draw on knowledge from the project appraisal branches and from audited claims (observations and qualifications by project auditors). However, the necessary recording and feedback systems have yet to be established. For example, WEFO does not classify and collate errors identified by project auditors and its financial control team. This is necessary to manage risk and share information in a systematic way - currently WEFO does not know definitively whether the accuracy of its underlying expenditure is improving from the serious problems experienced in the 1994-99 programmes.

4.15 The "aftercare" visits by the local partnerships, and the monitoring visits by WEFO, will provide useful information on general progress and the results of this work also need to feed back to the relevant staff within WEFO so that any implementation problems can be managed in good time. Experience has shown that projects often fall behind schedule, but project sponsors fail to update their forecasts realistically to reflect the slippage. This makes it very difficult for WEFO to manage expenditure to avoid decommitment, as it cannot rely on the information supplied by sponsors with their monthly claims. There is a better chance of assessing the true position in a face to face meeting.

4.16 There remains some overlap between the various control measures. The financial control inspections and project audits in particular cover much of the same ground. The main difference is that WEFO examines projects on a sample basis and in greater depth, whereas the audit requirement covers almost all projects. Nevertheless, for those projects that are subject to both checks, there will be duplication of work. European Commission regulations require both types of control, which means that a degree of duplication in unavoidable. As part of its review of the audit requirement, WEFO should consider practical ways of reducing the inspection burden on project sponsors. This could involve, for example, reviewing the threshold at which an audit is required (currently £20,000 for ESF, but nil for the other Funds) and requiring a single audit for smaller projects rather than an audit every year.

WEFO monitors the programmes effectively and now plans to verify data on a selective basis

4.17 The European Union has established a strict framework for monitoring the benefits of the Structural Funding programmes in each member state: all operations must contribute towards agreed, quantifiable targets, and progress must be reported regularly to Programme Monitoring Committees and the Commission itself. European regulations also require WEFO to commission an external mid-term evaluation of each programme to assess its progress and the continuing relevance of the strategy that underpins it.

4.18 The absence of an integrated database prevented WEFO collating information on the planned and actual outputs of each project until late 2002, meaning that it was impossible to analyse progress against targets at the programme level (although at that time relatively little of each programme had been spent and even fewer outputs would have been delivered). The Audit Committee was concerned that a system for recording outputs had not been established over two years after the start of the programmes, and pointed to three stages in the development of a sound monitoring system:

- the selection of appropriate targets;
- implementing a system for recording and analysing outputs; and

- verifying the information received to ensure that progress against the targets is correctly reported. This may take the form of ongoing verification as well as less frequent but more targeted in-depth evaluations.

WEFO has rationalised its system of targets but the mid-term evaluations have suggested further improvements

4.19 WEFO initially rationalised the targets for Objective 1 in 2001 after it became clear that some targets at the Measure level were inconsistent with higher-level targets, while other indicators were inadequately defined. The mid-term evaluation for Objective 1 endorsed most of the targets and confirmed that the programme strategy remained relevant. It recommended some changes to the system of monitoring outputs, most of which were accepted by WEFO **(Figure 9)**.

WEFO now has the capacity to collect and analyse monitoring information effectively

4.20 The grant management information system that was implemented progressively during 2002 now collates all the planned and actual outputs of the Structural Funding programmes in Wales, and permits extensive analysis of outputs for particular Measures and geographical areas. This data is analysed in detail by the monitoring sub-group of the Objective 1 Programme Monitoring Committee, and is used to report overall patterns and trends to the various Programme Monitoring Committees and the Economic Development and Transport Committee of the National Assembly.

4.21 The partnerships and Thematic Advisory Groups also receive detailed reports on the main outputs in their area or part of the programme, including the potential contribution of projects being appraised by

9 Changes suggested in the Objective 1 mid-term evaluation to the system of targets and output indicators

Change proposed	WEFO's response
Simplify the structure of targets wherever possible, replace relative measures and ensure consistency between the high-level targets and those in the Programme Complement. Various amendments proposed	WEFO is incorporating most of the changes into its revision of the Programme Complement, but considers it inappropriate to amend high-level targets at this stage in the programme
Define some indicators more clearly, as interpretation varies among project sponsors, and in some cases the claims made are unconvincing Jobs, beneficiaries and SMEs assisted are the main indicators that need to be reviewed	Job definitions produced and disseminated
Commission research on double-counting of outputs between projects: this is likely to happen as there are no controls to prevent it	WEFO to commission research
Ensure that all targets are being measured and that progress can be assessed. Few projects have systems to measure the growth in turnover of their beneficiaries, and for some targets baseline data is not easily available so progress cannot be measured	WEFO is investigating how turnover growth can be measured and is considering how baselines can be established
Allow more flexibility for projects to create their own targets and report on achievements outside the current structure of targets. Currently there is no provision to report "soft outcomes" in the project claims, and some project sponsors feel that the true value of their project is not fully assessed	WEFO will not do this as it would make administration and reporting more complicated
Greater focus on project level evaluation, which should be compulsory for projects receiving over £1 million in grant.	Projects that receive more than £2 million in grant must be independently evaluated. WEFO also requires the first phase of a project to be evaluated before it approves a second phase, and will use the evaluation as part of the appraisal process

WEFO. Some indicators are further divided into various categories - for example, jobs are analysed by gender, ethnicity and language, while firms assisted are analysed by size and economic sector. This level of detail is awkward to collect for project sponsors (especially those who operate across local authority and sectoral boundaries) but should facilitate a much more sophisticated level of monitoring and evaluation than has been possible in the past. The detail is also needed to meet the expectations of partnerships and politicians, who are sometimes interested in the progress of the programmes in very specific sectors or geographical areas.

There are some problems with data quality and WEFO plans limited checking that the data is correct

4.22 The Objective 1 mid-term evaluation raised some concerns about the quality of output data provided by project sponsors, and pointed out that it is very difficult to verify outputs objectively. As noted in Figure 9, project sponsors interpreted certain indicators in different ways and in some cases the claims appeared to be exaggerated. While most projects had systems to prevent double-counting of outputs within their project, there were no controls to prevent this between projects. WEFO is taking steps to improve awareness by issuing new guidance, and will research the extent of double -counting as part of a forthcoming evaluation on the impact of the programmes.

4.23 Until now there has been limited checking that the output data provided by project sponsors is correct, but this has begun to improve as WEFO has extended its financial control visits to cover the current programmes. ESF project auditors also review systems to ensure that beneficiaries are correctly recorded. The new project monitoring team will visit projects at an earlier stage and will check that sponsors use the correct definitions of key indicators, have robust baselines against which to measure progress and appropriate systems for gathering data.

KEY POINTS ON HELPING TO DELIVER WHAT IS PROMISED

On financial control

- WEFO has established a system of sound financial controls and is developing it further to meet the needs of the programme
- Inconsistencies remain in the scope of work that project auditors are asked to undertake. WEFO has reviewed the ESF audit instructions but not those for the other Funds.
- The financial control team has cleared the backlog of inspections caused by the late start on the previous programmes and has met the target for the Performance Reserve. It has improved its procedures to address weaknesses identified during the closure of the previous programmes.
- WEFO has recently established a project monitoring team to visit project sponsors at an early stage to review general progress and confirm that the key controls are in place. Together with visits by local partnerships, this should address the concerns raised by the Audit Committee and the Objective 1 mid-term evaluation that WEFO should have more direct contact with projects during the implementation stage.
- WEFO needs to ensure that the results of project monitoring and control feed back to those who can use it to assess risk and improve programme management.
- There is a degree of duplication between the project audits and WEFO's financial control inspections, and WEFO should consider practical ways of minimising the burden on project applicants where European Commission regulations allow.

On programme monitoring

- The mid-term evaluations have generally endorsed the targets set for the programme but have suggested some changes and improvements. WEFO is acting on most of these but has decided against some of the proposals.
- WEFO now has the capacity to collect and analyse monitoring information through its IT system, and produces a wide range of reports.
- There are some concerns about the quality of output data reported by project sponsors, and WEFO is taking steps to improve this by issuing new guidance and reviewing systems at project sponsors.

5 Keeping the money

WEFO needs to meet expenditure and performance targets to maximise the amount of Structural Funding for Wales

5.1 The European Union agrees a profile of spending for each programme, and sets minimum expenditure targets for each year starting from the end of the third year of the programming period. Each programme must meet these targets otherwise the unspent balance is withdrawn ("decommitted") and the Structural Funding is permanently lost. This requirement is known as the N+2 or decommitment rule **(see Box B)**, is set down in European law and applies equally to all member states. A separate target is set for each Structural Fund within each programme.

5.2 In addition, there is a Performance Reserve equivalent to four per cent of the total programme budgets of Objectives 1, 2 and 3. To qualify for the reserve, the programme must meet most of a set of performance criteria that are agreed in advance with the European Commission. These criteria related to finances (including a requirement to have spent enough to avoid decommitment), management (for example, in relation to the quality of appraisal and monitoring systems) and effectiveness (achievement of key output targets). The criteria are assessed at the mid-term of the programmes, usually based on the position at 31 December 2003. If a programme qualifies for the reserve, the additional funds are allocated to the most successful programme priorities over the remainder of the programming period.

5.3 In common with other programmes across Europe, Wales has suffered in the past from slow initial spending with a rush of payments at the end of the programming period. Delays in approving grants and spending money at the start of the current programming round reinforced fears that these problems would be repeated, and the Audit Committee asked WEFO to ensure that everything possible was done to benefit from the Performance Reserve and to avoid decommitment. This part of the report examines how successful WEFO and its partners have been in meeting this objective.

WEFO met the targets necessary to earn the Performance Reserve

5.4 The European Commission confirmed in March 2004 that Wales would qualify for the Performance Reserve for each of the three main programmes (Objectives 1, 2 and 3). This will provide an additional £65 million over the remaining three years of the programming period, for which no extra match funding will be needed. To qualify, each programme was set a target of meeting 75 per cent of the criteria in each category

B The N+2 or decommitment rule

The N+2 rule was introduced for the 2000-06 Structural Fund programmes to encourage tighter financial management and avoid payments building up sharply towards the end of the seven-year programming period. The budget for each programme is generally allocated quite evenly across the period. In essence the N+2 rule requires each year's allocation to be spent within two years.

For example, the allocation for 2002 needs to be spent by the end of 2004. The regulations recognise that it takes time to establish a programme and each one is therefore given an advance of seven per cent of its total value at the start of the period. This advance is offset against the decommitment targets, and must then be spent before the programmes close in June 2009.

The target relates to the cumulative amount that WEFO claims from the European Commission for reimbursement of eligible expenditure (payments to project sponsors to reimburse costs actually incurred by them). To count against the decommitment target, the Commission must receive the claim by the target date.

of targets - financial, management, and effectiveness, with particular emphasis on the financial and management criteria. A summary of the criteria and performance against them is shown in **Figure 10**.

5.5 WEFO comfortably achieved the majority of the measurable targets, exceeding many of them by a wide margin. However, retrospective projects (those funded by WEFO after they had taken place - see paragraph 5.10) played a significant part in meeting the effectiveness criteria for Objective 2 and financial criteria for all the Objectives.

5.6 The reserve has been allocated to those Measures that WEFO considers have the best potential for meeting strategic objectives and priorities, based on the findings of the mid-term evaluation and review. Generally these are also Measures with a high level of demand that were largely committed and spent at the mid-term. The projects that will benefit are those dealing with economic inactivity, innovation, infrastructure, fisheries and aquaculture, and financial support to small and medium-sized enterprises. For Objective 1, town centre regeneration will also be funded for the first time.

10 Performance Reserve

Criteria	% of targets achieved (at 31 Dec 2003)		
	Objective 1	**Objective 2**	**Objective 3**
Effectiveness criteria A range of output indicators for activities (measuring direct provision of services, e.g people trained) and results (benefits achieved, e.g. gross jobs created), covering a range of Measures and usually set at between 20% and 30% of the target for the whole programming period	**85** 84 (activities) 88 (results)	**71** 67 (activities) 100 (results)	**79** 77 (activities) 83 (results)
Management criteria Four criteria covering quality of monitoring system, use of clearly defined selection criteria, completion of acceptable mid-term evaluation	**100**	**100**	**100**
Financial criteria Two criteria: spending targets met (no decommitment), amount of private sector match funding	**100**	**100**	**100**
Value of performance reserve	**£57.5m**	**£3.8m**	**£4.1m**

NOTE

The European Commission awarded the Reserve based on estimates of the position at 31 December 2003. These estimates were broadly confirmed by the actual data submitted by claimants after the end of the year. The European Commission also accepted WEFO's proposal that several of the results indicators should be disregarded because accurate data on performance was not available.

Source: WEFO (database of outputs and submissions to the European Commission) and the European Commission (Decision of 23 March 2004 on allocation of the Performance Reserve)

WEFO met all its decommitment targets for 2003 but relied on special measures to help achieve them

5.7 WEFO met all its decommitment targets in 2003, some of them by a comfortable margin **(Figure 11)**. However, the targets proved exceptionally challenging - to some extent because of the impact of exchange rate fluctuations **(see Box C)** - and some were achieved as late as December, representing the culmination of an intensive effort to generate additional expenditure. The result is that WEFO avoided the loss of £105 million that would otherwise have been lost due to decommitment (£40 million) and the loss of the Performance Reserve (£65 million).

5.8 In view of the importance it attached to avoiding decommitment, WEFO established in 2002 a working group of senior officials to monitor the expenditure position and ensure that WEFO took appropriate action to meet the N+2 targets. The group met monthly to assess progress and review reports on expenditure, outstanding grant claims and forecasts of future spending. These reports became more sophisticated during the final quarter of 2003, with sensitivity analyses showing how performance against the targets

C Exchange rate movements made the decommitment targets more challenging

Wales receives its Structural Funding in euros, but WEFO pays project sponsors in sterling. WEFO works on the basis of an estimated exchange rate that reflects current markets, but claims to the European Commission are based on published exchange rates for the month of payment. In June 2003 WEFO amended the planning rate from £1 = €1.62 to £1 = €1.40 to reflect a sharp drop in the exchange rate over the previous three months. This made it substantially more difficult to meet the decommitment targets; an additional £25 million of spending was necessary compared with what would have been needed if the previous planning rate applied.

Had the previous exchange rate applied throughout 2003, WEFO would have met all of its decommitment targets, other than for Objective 1 EAGGF and Objective 2, without the need for special interventions described below.

11 Decommittment targets for 31 December 2003 compared with expenditure achieved

Programme and Fund	Target, £m (see note below)	Achieved, £m	Achieved as % of target	Target met?
Objective 1 - ERDF	172.9	184.0	106	✓
Objective 1 - ESF	88.4	93.9	106	✓
Objective 1 - EAGGF	20.4	23.0	113	✓
Total for Objective 1	**281.7**	**300.9**	**107**	
Objective 2 (ERDF)	24.7	24.9	101	✓
Objective 3 (ESF)	21.6	25.4	118	✓
Interreg IIIa (ERDF)	2.6	2.7	103	✓
Leader+ (EAGGF)	0.9	1.1	118	✓
Urban II (ERDF)	0.6	0.7	117	✓
Total	**332.1**	**355.7**	**107**	

NOTE

Target is the fixed amount in euros translated into sterling at £1 = €1.439, the rate actually used to convert sterling payments into euros for the purposes of the December 2003 reimbursement claim to the European Commission. WEFO worked towards a slightly higher target calculated using the planning rate of £1 = €1.40.

Source: WEFO

would vary depending on the accuracy of project sponsors' spending forecasts. WEFO intensified its monitoring activity as the deadline neared, focusing on the programmes most at risk and the projects with most potential for avoiding decommitment.

5.9 It became clear by mid-2003 that grant claims in most areas were running far below the levels needed to meet the targets, and that additional measures would be necessary to avoid decommitment. The measures used to meet the 2002 targets - such as bringing forward expenditure by making monthly rather than quarterly payments to larger project sponsors **(see Box D)** - were unlikely to be enough in 2003. Managing authorities elsewhere in the United Kingdom faced very similar difficulties, and WEFO worked closely with other Government Departments to develop initiatives that would help generate expenditure quickly and to discuss these plans with the European Commission.

5.10 WEFO sought and obtained the agreement of the European Commission to two significant special interventions:

a) **retrospective funding** of projects that were already under way or had been completed, were eligible for support and could have been funded at an earlier stage had they applied to WEFO for a grant. These "missed opportunities" could be funded provided that the money released was recycled into other economic regeneration activities within the programme area. The emphasis was on large projects and programmes that clearly fitted with the relevant programme's strategy, but some smaller local projects were also found suitable **(Figure 12)**. As a result WEFO was able to offer grants for 28 retrospective projects, generating additional spend of £33.5 million; and

b) **increasing grant rates** - average grant rates in most Measures of the programme are somewhat below the planned averages agreed by the European Commission. By increasing the grant rate for certain projects and applying these changes retrospectively, WEFO was able to pay out more grant in time for the decommitment deadline whilst releasing match funding from other public sources to support more projects in the future. In addition WEFO altered the funding profile of some projects, so that projects were able to use more Structural Funding in the early years of the project compared to public sector match funding. This will be balanced in later years so that the net effect is to achieve the agreed grant rate. The net effect of these interventions was to generate an additional £9.3 million, of which £2.6 million was from the funding profile adjustments that will need to be recovered in later years.

D Requesting and paying claims as promptly as possible

Timely payment of grant claims helps the project sponsor as well as reducing the risk of decommitment. WEFO has improved its claim processing times (the average time between receipt and payment) for Objective 1 ERDF projects from 44 days in 2002 to 25 days in the 2003,and most claims are now paid within WEFO's target of 28 days. Claims were paid even faster in the weeks before Christmas 2003 to ensure that all grant claims from project sponsors were included in the last claim to the European Commission before the 31 December deadline.

In addition, WEFO asked all project sponsors who normally submitted quarterly claims to 30 September to submit monthly claims for October and November 2003. This generated an additional two months' worth of expenditure for these projects before the year-end, securing £14.4 million of European funding. This involved several hundred projects and extensive additional work for project sponsors and WEFO's payments branch.

E WEFO suspended normal audit requirements so that claims for retrospective projects could be paid before the decommitment deadline

WEFO normally requires projects to be audited annually, and withholds five per cent of the final grant claim until the completed project has been audited. Several retrospective projects were approved late in the year and could not be audited in time for the decommitment deadline. WEFO correctly withheld five per cent of the total grant, but this still meant that several projects were substantially paid without any audit coverage. In two cases, WEFO shortened the project from three to two years so that the completion date fell before the decommitment deadline, thus avoiding the need for interim audit certificates.

12 Special measures used by WEFO to help achieve decommittment targets for Objective 1

Type of intervention	Examples	Amount paid in 2003 (£000)
Retrospective projects: Grant schemes for small and medium-sized enterprises (SMEs)		9,193
	Regional Selective Assistance (Welsh Assembly Government)	1,776
	Capital grants and Intergrated Tourism Support for SMEs (Wales Tourist Board)	
Large capital schemes	Road schemes (Welsh Assembly Government)	9,551
	Sites and premises for SMEs (Welsh Development Agency)	1,338
Local regeneration projects	Improvement of the urban environment in specific locations	2,643
Environmental and countryside projects	Conservation, recreation, heritage and community projects in Assembly-owned forests (Forestry Commission)	3,279
	Nature reserves (Countryside Council for Wales)	1,120
	Smaller projects to regenerate ponds and rivers (Environment Agency)	156
Changes to grant rate:	Permanent increase in grant rate (WDA business support projects)	6,665
	Temporary increase in grant rate (WDA marketing and processing grant scheme)	2,649

Source: WEFO

5.11 The effect of these measures on WEFO's ability to meet the decommitment targets is shown in **Figure 13**. WEFO would not have been able to meet three of the major targets - ERDF and EAGGF for Objective 1, and ERDF for Objective 2 - without these special interventions. In the event, however, the aggregate effect of the special interventions and the other steps taken by WEFO to generate expenditure meant that most decommitment targets were met comfortably. This puts WEFO in a stronger position to meet the targets for 2004, because part of the additional spending that is needed to meet the target has already been achieved. For example, spending on Objective 3 was £3.8 million over the £21.6 million target at 31 December 2003, which is nearly a third of the £12 million of additional spending that is needed to meet the £32.4 million spending target for 2004.

5.12 In 2003 WEFO restricted retrospection to public bodies, on the basis that the process would be easier to manage to the very tight timescales required and that these organisations, with their wide-ranging activities and large budgets, would be better placed to recycle the money in other economic regeneration activities. WEFO intends to limit the use of retrospective funding in the future so that it is used only when required to meet spending targets and to meet shortfalls in particular Measures, but plans to identify potential projects at an early stage and to open up the option to all local partnerships.

13 How WEFO met its decommitment targets in 2003

	Objective 1				Obj.2	Obj.3	Total
	ERDF £m	ESF £m	EAGGF £m	Total £m	£m	£m	£m
Target	172.864	88.396	20.409	281.669	24.652	21.626	327.947
Achieved without special measures	148.114	93.849	14.477	256.440	16.623	20.929	293.992
Shortfall/(Surplus)	24.750 14%	(5.453) -6%	5.932 29%	25.229 9%	8.029 33%	0.697 3%	33.955 10%
Special measures:							
Monthly claims	11.481	0	1.492	12.973	1.401	0	14.374
Retrospection	17.789	0	4.398	22.187	6.867	4.493	33.547
Permanent grant rate changes	6.665	0	0	6.665	0	0	6.665
Temporary grant rate changes	0	0	2.649	2.649	0	0	2.649
Total special measures	**35.935**	**0**	**8.539**	**44.474**	**8.268**	**4.493**	**57.235**
Total expenditure achieved	**184.049**	**93.849**	**23.016**	**300.914**	**24.891**	**25.422**	**351.227**
Special measures as a proportion of total expenditure achieved	20%	0%	37%	15%	33%	18%	16%

Source: National Audit Office analysis of WEFO's database and management accounts

5.13 The retrospective projects were subject to the same conditions as other projects and WEFO carried out its standard appraisal and payment checks, including a requirement for the audit of completed projects. However, it was possible for WEFO to shorten the appraisal process as the results and progress of the projects were already known. The main risk of retrospection is added value: each grant substitutes European money for UK public expenditure. The United Kingdom as a whole needs to ensure that retrospection does not jeopardise additionality - the requirement that each member state maintains its own spending on the broad range of activities covered by the Structural Funding programmes so that the Funds add to, and do not replace, domestic expenditure. In common with the rest of the United Kingdom, WEFO requires all retrospectively-funded project sponsors to bring forward proposals for spending the money released by retrospection on additional activities that are compatible with the objectives in the programme strategy. These proposals must be approved by WEFO and be implemented fully before the closure of the programme in 2009. At 31 March 2004, not all of the organisations that had received retrospective funding had submitted firm proposals for the use of the domestic funds that had been released. WEFO will need to monitor this carefully to ensure that its retrospective projects add the same value as projects approved in advance of implementation.

A number of factors throughout the project cycle affect WEFO's ability to meet decommitment targets

5.14 WEFO faces the need to generate expenditure and avoid decommitment for each of the remaining years of the current programmes. The targets - set out in **Figure 14** for the Objective 1 Programme - will continue to be challenging as WEFO will gradually lose the benefit of the initial seven per cent advance.

5.15 Spending rates reflect the efficiency of everyone involved in the project cycle from the development of projects to their final payment by WEFO. The fact that special measures were needed at all reflects delays in generating expenditure from existing projects. There remain some underlying issues that will continue to affect WEFO's ability to continue to meet decommitment targets, and that it will therefore need to manage carefully. The speed with which WEFO appraises projects - considered at paragraphs 3.25 -3.31 - is one such factor, as in most instances a project cannot start to spend until it has been appraised and approved by WEFO. Other factors - late claims by project sponsors, projects spending less than forecast and the level of project approvals - are considered in more detail below.

14 Objective 1 spending targets: amounts that WEFO must spend to avoid the decommitment of funding

Date	Target (€m)	% of budget	
31 December 2002	154	8	2000 allocation less 7% advance
31 December 2003	432	23	+2001 allocation
31 December 2004	705	38	+2002 allocation
31 December 2005	972	53	+2003 allocation
31 December 2006	1,209	66	+2004 allocation
31 December 2007	1,464	79	+2005 allocation
30 June 2009	1,845	100	+2006 allocation + recovery of 7% advance

Source: WEFO

WEFO made a concerted effort to pursue outstanding claims before the decommitment deadline but late claims remain a problem

5.16 Project sponsors are usually required to submit claims every three months, within 30 days of the end of the period to which the claim relates. Most sponsors are paid in arrears, although non-profit making organisations in the voluntary and private sectors have the option of receiving payments in advance (these advances do not count as eligible expenditure).

5.17 In our 2002 report, we found that many project sponsors were sending in claims late and that this was having a significant impact on WEFO's spending rate, with adverse implications on its ability to meet decommitment targets. The Objective 1 mid-term evaluations also reported in 2003 that late claims were a major problem, and that WEFO had not always pursued them rigorously due partly to staff shortages and high staff turnover. Project sponsors, meanwhile, complained that it was not always easy to speak to the right person in WEFO's payments branch and that their completed claims elicited a lot of sometimes baffling questions before they were paid.

5.18 Late claims remained a significant problem throughout 2003, with many sponsors submitting them several months after the due date and in some cases over a year late. WEFO pursues overdue claims systematically - there is a clearly defined procedure involving telephone and written reminders, culminating in a final letter to the organisation's chief executive threatening to withdraw funding if a claim is not received (although this threat has not yet been carried out). WEFO also meets project sponsors and initiates high-level contact if there are persistent problems.

5.19 WEFO does not retain or analyse information at an aggregate level on overdue claims and the action taken to pursue them, so it is not possible to specify the numbers involved, their likely value or the average delay. As an example, however, 70 of the 450 Objective 1 ERDF claims due for return in July 2003 had not been received by the end of August, and 50 were still outstanding at the end of September. In addition, 18 projects had not submitted claims for the period to the end of March by 31 August. WEFO had managed to make a substantial improvement by the end of November as a result of an intensive effort to pursue overdue claims in time for the decommitment deadline. As a result, late claims did not have a significant impact on meeting the 2003 spending targets.

5.20 WEFO informed us that the worst offenders were other public sector bodies, particularly Assembly-Sponsored Public Bodies and local authorities. The private and voluntary sectors generally had the best record. A major reason for this difference appears to be cash flow; public agencies are able to draw down their core funding as they need it and tend to use this, rather than Structural Funds, to finance their projects. In contrast private companies - especially those that do not receive advances - have a stronger incentive to claim quickly. Also, most of the largest projects are in the public sector and these are more time-consuming and complex to claim for.

5.21 More generally, the complexity of the claim form deters prompt completion. The information required on expenditure is fairly straightforward, but project sponsors have to report outputs in some detail (including analysis by location and economic sector for some indicators) and to re-assess their quarterly forecasts of expenditure and outputs. This results in a claim form that is typically 16 pages long, and can be off-putting to sponsors even if many of the boxes do not need to be completed. WEFO has tried to make the process easier for applicants by sending out claim forms that already contain information on targets and previously reported figures, but will not reduce the amount of information required from sponsors as it considers that it is needed to meet European Union requirements, provide monitoring data to the level of detail required by Programme Monitoring Committees and Partnerships, and to manage its own finances. This issue is likely to remain until such time as WEFO develops an electronic claims system that simplifies data entry and allows claims to be made over the Internet (paragraphs 2.11-2.12).

There is a chronic problem of projects spending less than they forecast

5.22 WEFO requires each project sponsor to provide a spending forecast when their project is approved, and to update this every time a claim is submitted. WEFO uses this information to forecast its own payments. Unfortunately, experience has shown that these forecasts - both the original spending profile and the subsequent updates - are highly inaccurate. For example, Objective 1 claims received in July 2003 came in at an average of 40 per cent below profile, but predicted an improvement to 10 per cent below profile by the end of September.

5.23 This position reflects a combination of project delays and under-spending of the total project budget. WEFO has undertaken preliminary analysis which indicates that completed projects underspend by an average of 4 per cent for non-ESF projects, 9 per cent for Objective 1 ESF projects and 19 per cent for Objective 3 projects; for ESF spending is generally 20-25 percent below profile whilst projects are in progress. WEFO asks project sponsors to explain any significant variation from projected spend and has tried to develop a basic forecasting model; however it has proved difficult to predict expenditure and WEFO plans to undertake further analysis based on more extensive data. Nevertheless, WEFO considers that it has a good understanding of the reasons for under-spending, especially for larger projects. We reviewed the mid-term evaluations (which examined in detail a sample of projects) and discussed the issue with WEFO staff. Common reasons for under-spending appear to include:

- preparing forecasts based on the date that expenditure is incurred, rather than paid for (claims must be based on payments);
- under-estimating the time taken to establish a project, especially to recruit staff;
- over-estimating project costs at application, often to provide the sponsor with a "cushion" against unexpected costs (contingencies are not eligible under WEFO's own rules for Structural Funding); and
- project sponsors may "over-promise" at the application stage, especially in terms of more innovative, developmental activities.

5.24 Since WEFO is not responsible for implementing the projects that collectively deliver the programme - this is the job of the individual project sponsors - there is little that it can to do directly to speed up the progress of projects. The evaluation of spending rates that is currently being undertaken and the planned programme of monitoring visits will help to build on WEFO's understanding of why projects under-spend and to react quickly if major problems are foreseen.

Overall project approvals are running to plan, but there are shortfalls in some areas

5.25 Ultimately the success of the programmes depends on the number, value and quality of projects that are approved for grant. This depends on a good supply of projects in the development stage. WEFO prepares an Annual Monitoring Business Plan at the start of each calendar year which forecasts the value of grant approvals for the year ahead, based on known development work ("projects in the pipeline"). This is compared with the indicative allocation for each Measure, based on the financial allocations agreed with the European Commission at the outset of the programme; these grant approval allocations are important as they relate directly to the decommitment targets (the latter are based on subsequent spend). **Figure 15** shows the position at the end of 2003.

15 Committment levels for the main programmes by Fund, as at December 2003

Programme	Indicative allocation £m	Grants approved £m	% of indicative allocation achieved
Objective 1 - ERDF	459.9	400.9	87
Objective 1 - ESF	233.3	211.7	91
Objective 1 - EAGGF	53.7	62.1	116
Objective 1 - FIFG	6.3	6.7	108
Objective 2	58.6	45.4	77
Objective 3	54.6	41.6	76
Total	866.4	768.4	89

Source: monitoring report for the Economic Development and Transport Committee of the National Assembly, January 2004

5.26 Overall, there is a reasonably good level of commitment in most Measures and programmes. By the end of 2003 WEFO had approved grants totalling £768 million, representing about 51 per cent of the total for the programmes and 89 per cent of the indicative allocation for the period. Progress has been especially good in training and business finance Measures, largely because there are well-established training and grant schemes that have been co-financed by the Structural Funds. These are also the Measures that are most likely to have received retrospective funding as part of the effort to avoid decommitment in 2003; performance against indicative allocation falls to 85 per cent if the retrospective projects are excluded. Progress has been slower than expected in several other Measures and Programmes, as outlined in **Box F**.

WEFO has a funding strategy to help ensure that the Structural Funds are fully spent by the end of the programming period

5.27 The Assembly Government has to balance a range of factors in meeting the spending targets for the European programmes. It needs to ensure that enough funds are committed to ensure that the money available is fully spent, taking into account uncertainties about the exchange rate and project slippage and underspending. However, if spending exceeds expectations or the euro strengthens, any shortfall in European funding would mostly have to be met from the Assembly's budget.

F Areas where project approval has been slower than forecast

Objective 2

The programme was approved late by the European Commission, but was expected to catch up fully in terms of expenditure by the end of 2003. The restricted range of activities, and restricted geographical areas that are eligible for support, together with state aid constraints, has made it more difficult to bring forward viable projects. The Finance Wales investment fund for the Objective 2 area was not approved until late in 2003 due to negotiations with the European Commission and the private sector funders; this also hindered spending and commitment rates. As a result, the programme has struggled to commit funds although several large projects are now in place. Commitment rates remain low for Measures based on smaller local projects, especially those related to social inclusion and community economic regeneration. As with Objective 3, the local partnerships - each of which receives its own allocation of funds - differ markedly in their commitment rates.

Infrastructure Measures in Objective 1

There were problems from the outset of the programmes in developing strategies for the use of the limited money available for broadband infrastructure, transport projects, sites and premises and clean energy projects. In some cases, this was a question of prioritising between a large number of potential applications that would have greatly over-subscribed the Measure. This was the case with sites and premises for SMEs, and the issues have now been resolved with most of the funds committed. A clear strategy has also been developed to prioritise transport projects, and several projects are currently being appraised. Progress on broadband infrastructure was delayed while the Assembly Government developed an ICT strategy. This is now in place, but progress in developing and approving specific projects has been slower than expected.

Less progress has been made with the other Measures, where more fundamental issues are involved. Regulatory issues have prevented the development of environmental infrastructure projects, which were limited to "orphan sites" - where ownership and liability for pollution cannot be identified - and this greatly restricted the interest from potential applicants. This restriction has now been removed, which should enable faster progress to be made. For clean energy projects, the pool of potential projects has been reduced because wind farms are now considered to be commercially viable in their own right, and it is not therefore appropriate to fund them with public money unless there is a clear community interest through local ownership. Guidance is now being developed to ensure that projects come forward. Progress will need to be made quickly if these time-consuming capital projects are to be completed in good time for the closure of the programmes in 2009.

Community economic regeneration

A wide range of factors have been cited as reasons for the slow progress in this area, where less than 50 per cent of the planned commitments have been made. These Measures depend on grassroots community involvement in the development of projects, and capacity is limited, while the money set aside for capacity building - which needs to take place before substantial investment can take place - has been spent much more slowly than expected. The mid-term evaluation also cited a lack of integration with the Communities First programme as a significant issue - the areas funded by Objective 1 do not coincide with the deprived areas covered by Communities First, and many community organisations prefer to seek funding through Communities First as it is simpler and quicker. As described at paragraph 3.8, WEFO is now taking forward the recommendations of an independent report commissioned by the Wales Council for Voluntary Action and is considering ways of more closely integrating the Structural Funds with Communities First.

Regulatory and compliance issues

More generally there has been a problem with some large projects in ensuring that they comply with relevant UK and European legislation and financial controls. The Finance Wales projects took more than two years to receive approval from the European Commission. State aid issues have delayed approval of several large private sector projects, while some large training programmes run by ELWa have been delayed by doubts about the legality of the funding arrangements for training providers. These issues have largely been resolved, although the application of state aids regulations to the more innovative, non-public sector projects continues to be challenging.

ESF projects

WEFO has found it easy to commit funds for standard training programmes such as Skill-Build and Work-Based Learning for Adults, which are well-established. There has been more difficulty in identifying projects for re-integrating the long-term unemployed into the labour market and developing childcare facilities to help raise female participation rates in the workforce. Assistance specifically targeted at these groups is much less developed than college-based and work-based training, and WEFO is now working with the relevant divisions in the Assembly Government to commission large, all-Wales projects specifically for these Measures.

5.28 For Objective 1, WEFO plans to adopt the following strategy to ensure that the Funds are fully spent:

- **forward commitment**: approving grants at a faster rate than planned. WEFO is setting a target for 2004 to commit 25 per cent of the 2005 indicative allocation, in addition to the cumulative 2000-2004 indicative allocation, in order to bring forward future spending and reduce the risk that slippage on key projects would jeopardise spending targets;
- **over-programming**: approving grants to a total value that exceeds the funds available, on the basis that the difference will be offset by projects under-spending;
- **co-financing**: using the Structural Funds to expand or create large Assembly or other public agency programmes that will deliver specific strategic objectives, especially where there are gaps in spending or delivery. WEFO expects this approach - known as strategic delivery - to make programme management easier by limiting the number of projects, targeting resources where they are most needed and making it easier to scale back provision as spending declines with the end of the current round of programmes; and
- retrospective funding of projects and varying grant rates: these options will be used if necessary to meet any residual shortfalls arising from under-spending, slippage or exchange rate variations.

5.29 Overall, WEFO plans fully to have spent the Structural Funds by June 2008, some six months ahead of schedule. This will leave a year to close the programmes, which involves extensive monitoring and audit work, and was rushed and difficult for the 1994-99 programmes that closed in 2003. WEFO is already much better prepared for programme closure than it was under the previous programmes as it has established better management information and control systems. WEFO's strategy for fully using the Structural Funds appears appropriate but will require close monitoring and coordination to ensure that the Assembly's budgets and programmes are mobilised to deliver the right projects at the right time. WEFO has been able until now to meet the spending targets by concentrating resources where it is easiest to spend money, for example by co-financing large road or business grant schemes. These opportunities will diminish as the programme continues and gaps remain in the most difficult areas. WEFO is aware of the challenge, and the key to success will be the concept of strategic delivery as well as the skilful management of financial risk.

KEY POINTS ON USING ALL THE MONEY AVAILABLE

- WEFO has achieved the targets necessary to qualify for the performance reserve, thereby gaining an additional £65 million of Structural Funds.
- WEFO met all its decommitment targets for spending to the end of 2003 - targets that were made more challenging by exchange rate movements earlier in the year.
- WEFO monitored the spending position carefully and took appropriate measures to maximise expenditure. This involved a lot of hard work on the part of project sponsors and WEFO staff in preparing and processing monthly instead of quarterly claims.
- WEFO also needed to employ special measures, such as retrospectively funding existing projects and reducing the proportion of match funding required, to meet its targets.
- Decommitment targets will continue to apply at the end of each calendar year for the remainder of the programmes. There remain a number of factors in the current arrangements which WEFO needs to manage carefully to minimise the risk of money being lost to Wales: these include the problems of late funding claims from project sponsors, projects spending more slowly than forecast. And in some areas of the programmes, good projects have been relatively slow in coming forward.
- WEFO has an appropriate strategy to help ensure that all the available funds are used and to ensure a well-managed closure of the programmes. As well as skilful financial management, WEFO and its partners will need to be proactive in targeting gaps in the programmes so that every Measure is fully spent.

Appendix 1

Update on recommendations made by the Audit Committee of the National Assembly for Wales

	The Audit Committee recommended[3] that	Response of the Welsh Assembly Government	Current position noted in the report
i	For future programmes, the basic management arrangements are settled well in advance of the programme's launch, and that comprehensive guidance for partnerships and applications be issued in good time;	We are already making an important contribution to the dialogue on the future role of the Structural Funds beyond 2006. Once we know what support systems will be available to Wales when the present programmes come to an end, we can decide what management arrangements need to be in place to make the very best of them. This will be informed by the effectiveness of past and current programmes and the related management arrangements and the lessons learned from those will be applied.	The Assembly Government plans to develop management arrangements based on future decisions at the European level on the amount and nature of funding, as stated in regulations that have yet to be developed. It also plans to incorporate the main lessons highlighted by the mid-term evaluations and reviews. The Assembly Government believes that the removal of WEFO's agency status - it is now fully integrated within the Welsh Assembly Government - will facilitate closer working within the Economic Development and Transport Department.
ii	WEFO monitors rigorously the geographical distribution of programme expenditure and benefits, to identify areas of common concern, and to take a proactive role in assisting partnerships to develop solutions;	WEFO will monitor expenditure as well as outputs by local partnership area, though the former will be subject to possible inconsistencies in the way expenditure is apportioned by project applicants. It is the outputs rather than the inputs that matter, i.e. .it is the way that the grant is invested and that impact that they will have in the area that is important. WEFO already works with and advised both local and regional partnerships in their development of projects. A series of workshops is also being organised by WEFO and the strategy partnerships to disseminate best practice and good ideas.	WEFO now provides detailed reports to partnerships and thematic advisory groups on the outputs predicted and achieved by the projects that fall within their remit. These reports are issued every three months and assist partnerships in their monitoring of the programmes (paragraph 2.8). This information is now being refined to include data at the level of Priorities within each programme. The partnerships and thematic advisory groups are responsible for using the data sent in formulating their strategies; WEFO has not yet undertaken any detailed mapping work to identify areas where shortfalls exist.
iii	WEFO and the Assembly take all necessary steps to ensure that WEFO is sufficiently resourced to carry out the full range of its work;	WEFO will continue to be resourced to carry out its work effectively and vacancies will be filled as quickly as possible.	WEFO is subject to standard Assembly personnel procedures. These have been streamlined to some extent and more staff are now recruited directly from external sources, but the process remains time-consuming. The vacancy rate has stabilised at 6-8 per cent of the complement for fully operational areas of the business, and there has been no significant adverse impact on WEFO's ability to deliver its core objectives (paragraphs 2.3 - 2.4).

3 *European Union Structural Funds: maximising the benefits for Wales, Report 08-02 presented to the National assembly 5 December 2002*

	The Audit Committee recommended[3] that	Response of the Welsh Assembly Government	Current position noted in the report
iv	WEFO takes all reasonable steps to ensure the timely completion of the remaining phases of the required IT improvements and urge it to do everything possible to keep the costs of achieving this to a minimum, new computer systems being notorious for time delays and cost escalation;	The project to enhance the functionality of WEFO's IT system was completed as forecast in September 2002 within budget. We agree with the Committee that any further enhancements should be achieved at minimum cost.	The planned enhancements are substantially complete and are functioning effectively. The first phase was completed four months later than the original target date and slightly over budget, but is now providing much better management information that largely meets WEFO's needs. The new system has automated much of the grant claims-handling process, making it more efficient. There is scope for further improvements but these depend largely on a new, customised system that is planned for delivery in time for the new programming round in 2007 (paragraphs 2.8 - 2.12).
v	WEFO seeks to be as proactive as possible in monitoring the availability and take-up of match funding so that problems - and possible solutions - can be identified by those who have the necessary influence to deliver improvements;	The Assembly Government remains committed to ensuring that "no good project will fail for lack of either match funding or public expenditure survey cover." The Assembly's budget lines that are specifically allocated for match funding are used where necessary, after other public and private sources have been considered. There has been a significant contribution from the public and private sectors and this in turn has affected the demand for match funding from these budget lines. To date we are not aware of any eligible project that has been turned away or failed for lack of match funding. In addition WEFO has published a series of factsheets providing information on the management and implementation of the Structural Funds in Wales. The factsheet on match funding explains the different types and sources of match funding and how they can be accessed by the voluntary, community and other sectors.	WEFO reports regularly on the overall contribution of match funding towards the total cost of each programme, and assists others to undertake more in-depth reviews as the need arises. None of the mid-term evaluations reported any significant problems in the amount of match funding available (paragraph 3.5). WEFO now provides extensive information on match funding sources on its website. The Assembly Government maintains two budgets specifically as sources of match funding for external bodies -Pathways to Prosperity and the Local Regeneration Fund. Demand for these funds has increased sharply and the Assembly Government has taken measures to manage this demand, which is likely to include increasing the amount of match funding provided by existing programme budgets (Box A on page 14).
vi	All remaining posts for the private sector facilitators are filled without further delay and that WEFO puts every effort into ensuring the success of the "blueprint" projects;	An application for technical assistance has been received from the North Wales Chamber of Commerce and Industry, who if successful will manage the project to deliver the six posts, and is in the final stages of approval. Job descriptions and people specifications have been drawn up and the posts have been advertised. Training for facilitators will be arranged by WEFO Private Sector Unit and is planned to take place in February 2003. The process for "blueprint projects" is currently being piloted with an ICT project for a data management service for SMEs. WEFO is looking to develop between six and twelve such projects with an average value of £5 million over the next two years.	The facilitators were all appointed by February 2003 and have exceeded targets to raise awareness of the programmes. There is also a target to raise the turnover of assisted business that will take longer to achieve (paragraph 3.13). Slower progress has been made with the blueprint projects (now known as template projects), but a process for their development and approval has been agreed. WEFO plans to approve a specification for the pilot project by mid-2004, and hopes to develop eight projects by 2005. (paragraph 3.15)

	The Audit Committee recommended[3] that	Response of the Welsh Assembly Government	Current position noted in the report
vii	WEFO keeps under review the project development and assessment process, with a view to removing or amending those elements which become superfluous. We agree with WEFO's intention of dispensing with the second phase of consultation with partnerships, provided that the first phase is working well, and urge that this be done at the earliest opportunity	WEFO is conscious of the need to ensure that the project development and appraisal process operates in an effective and efficient way and, with partners, keeps it constantly under review. There is no second phase of consultation with local and regional partnerships which could add to the timescale; but the project reports that go to the strategy partnerships are copied at the same time to the local and regional partnerships.	WEFO led a fundamental review of the process for Objective 1 and the new arrangements were accepted by the Programme Monitoring Committee in June 2003, coming into effect from January 2004. The number of partnerships has been reduced and most projects no longer have to be submitted through partnerships. The process has been streamlined by eliminating or combining several stages, so that key tasks overlap in order to minimise the overall duration of the process (paragraphs 3.17-3.20).
viii	WEFO uses its new information system to monitor appraisal times systematically, so that any problems or delays can be identified quickly	The information system can provide an analysis of the time taken to process an application within WEFO. WEFO will remain alert to problems or delays that arise and is also considering the scope for analysing the progress of projects during the development, ie proforma stage, but ultimately the quality of the projects that are approved is more important than the time taken.	WEFO has undertaken some detailed research into the duration of the appraisal process, and has enhanced its management information system to provide detailed information on the timing of various appraisal tasks. This data has been collected since July 2003 and WEFO is considering how it should be used to monitor and manage appraisal times on an ongoing basis (paragraph 3.27)
ix	WEFO continues to develop proposals for key funds and project commissioning, while monitoring closely the effect that they have on the rate of spend	A number of key funds have already been approved, mainly in Priority 3 and in the rural economic development Measures of Priority 5; the Wales Council for Voluntary Action is also managing the Social Risk Capital Fund. WEFO will continue to work with applicants to help them develop proposals where these will enable easier access to the programme. The identification of specific projects or specific needs has taken place in the infrastructure Measures dealing with transport and strategic sites and premises. Work is currently underway to identify energy projects which would be a priority for support under the programme. Project commissioning is also occurring in the case of "template projects". The rate of spend is closely monitored for all types of projects.	The use of key funds has been extended with more local authorities using them to support small local projects. Most local authorities in the Objective 1 area now have key funds for community economic development, but their use is not universal. WEFO considers that key funds are now well-established and has no plans for any significant expansion. Project commissioning or similar activity has taken place as described. Several energy and transport projects have been approved, and the Assembly Government is preparing a large childcare project to meet an identified need in that area (Box F on page 39). WEFO also plans to make greater use of the Structural Funds to co-finance existing Assembly Government programmes, which should have the same effect as key funds and project commissioning in meeting strategic needs and reducing barriers to access (paragraph 5.28 and Box F on page 39).

The Audit Committee recommended[3] that	Response of the Welsh Assembly Government	Current position noted in the report
x WEFO take early action to strengthen its guidance and develop a framework for assessing added value. We expect this to lead to greater clarify and a wider understanding of what is needed, and a rigorous risk-based assessment of added value at the appraisal stage.	WEFO's guidance on project appraisal has already been strengthened in each of these areas. On the issue of value for money of project costs and outputs, unit costs are already taken into account in the appraisal of ESF projects and the scoring criteria for ERDF/EAGGF/FIFG are being reviewed to ensure that the weighting given to unit costs is appropriate. Capital project costs are also benchmarked by professional advisers.	Revised guidance was issued in July 2002 and has evolved since then, and better guidance is now available to staff on how to assess added value, project need and other key judgements in the appraisal process. The mid-term evaluation for Objective 1 praised the framework and guidance used to select projects (paragraph 3.35). There continue to be problems documenting WEFO's assessment of the main appraisal criteria, especially those involving judgement. Internal Audit criticised the standard of documentation for WEFO's appraisal of Objective 1 ERDF projects (paragraph 3.35). WEFO has issued limited guidance on unit costs to help its officers to assess value for money, but does not wish to extend this as it considers that the variety and complexity of projects are not amenable to standardised costing. Instead WEFO is making greater use of professional advice, particularly for capital projects. WEFO has not revised the scoring criteria for ERDF, EAGGF and FIFG (Figure 7).
xi WEFO ensure that a suitably detailed assessment of project need is carried out forall projects, incorporating the work of partnerships where possible, and that in future this is properly documented on WEFO files		
xii WEFO develops of more consistent and robust system for assessing the value for money of projects costs and outputs		
xiii WEFO, perhaps through its financial control visits, takes steps to confirm early in the life of each project that good systems and record keeping arrangements are in place and that there are no serious problems in delivery.	WEFO procedures, which include a risk-based approach to audit, already contain a range of checks to try to ensure that project sponsors have appropriate systems in place. WEFO will consider whether its project appraisal and financial control procedures require further development.	This will be done mainly by the new project monitoring team (see (xv) below), who will visit about ten per cent of projects each year selected on the basis of a risk assessment (paragraphs 4.10-4.12). The financial control team also examines controls, but its work tends to take place at the later stages of a project once substantial expenditure and outputs have occurred.
xiv WEFO undertakes a review of the current arrangements for audit and financial control, with a view to improving the clarity and co-ordination of the roles of the external project auditors and its own financial control team.	WEFO has already introduced new arrangements for ESF interim and final claim audit. WEFO will be working with the National Audit Office to make improvements on the other Structural Funds and intends to publish a statement outlining the respective roles of external project auditors and financial control teams.	New arrangements for ESF audit were introduced in 2003, and provide more clarity on the nature and extent of testing that auditors should do. However, this has not been extended to a wider review of the guidance to project auditors, the scope of their work and how it should relate to WEFO's other systems of project monitoring and control. As a result some inconsistencies remain in the scope of work that auditors are asked to do and WEFO has not published a statement outlining the respective roles of external project auditors and financial control teams (paragraphs 4.5-4.7 and 4.13-4.16).

	The Audit Committee recommended[3] that	Response of the Welsh Assembly Government	Current position noted in the report
xv	WEFO considers adopting a policy of visiting all project sponsors at least once to review general progress and verify outputs information	WEFO is currently reviewing the scope for monitoring the programmes at project level and will consider the Committee's recommendation	WEFO has established a separate project monitoring unit of twelve people to visit projects in order to discuss general progress and review management and control systems. The unit aims to visit ten per cent of live projects each year, and to visit every applicant agency at least once over the life of the current programmes. Local partnerships will also maintain direct contact with project sponsors to review general progress (paragraphs 4.10-4.12).
xvi	WEFO takes all possible steps to minimise the risk of decommitment particularly on EAGGF and FIFG where those risks currently appear greatest	The spend target for EAGGF and FIFG for 2002 has now been achieved and this has ensured that there be no decommitment of funds this year. WEFO will in future years continue to monitor spend across the Funds and programmes and will work with partners to avoid any decommitment.	Spending targets for 2002 and 2003 were all achieved and no decommitment occurred. WEFO established a working group to monitor the situation and took appropriate steps to generate additional expenditure, including the retrospective funding of projects. These were instrumental in meeting the targets as spending through normal channels would have been insufficient. Project delays, late claims and underspending by project sponsors, and a lack of projects in some areas continue to hamper expenditure rates and need to be addressed to stabilise the long-term position (paragraphs 5.7 - 5.26).
xvii	We recommend that WEFO pays particular attention to developing its forecasting procedures - and the capability of project sponsors in the same area - to ensure that modest over-commitment, whilst tightly controlled and in line with recent trends, is sufficient to fully utilise the Structural Funds	WEFO continues to monitor commitment carefully and work is in hand both to develop forecasting models which will better relate commitment to spend and to develop reports which can identify problem projects. We do not exclude the possibility, in the light of this work, of some modest over-commitment at an appropriate stage	WEFO has not developed robust forecasting models but regularly reviews the commitment and expenditure position. WEFO estimates that projects typically spend at 40 per cent below the profile estimated when their grants are approved, some of which is due to over-budgeting. On the basis of the information available, WEFO plans to bring forward to 2004 25 per cent of the grant approvals planned for 2005, and to aim for closure of the programmes in mid-2008, (paragraphs 5.28-5.29).
xviii	WEFO and the Assembly Government together consider how the exchange rate risk can be managed in the final stages of the programmes when the scope for altering expenditure within the programming round will be progressively reduced.	The Assembly Government and WEFO will keep the exchange rate under review. It is too early to speculate on the position in 2009 but there is scope to adjust through amending approvals or issuing new ones right up to the final payment date if necessary in order to achieve the maximum possible from the programmes.	WEFO monitors the £/€ exchange rate and amends its financial plans if it varies by more than five per cent from the planning rate (currently £1 = €1.40). If the rate declines, WEFO could approve projects retrospectively or increase grant rates to absorb the additional funds. If the rate rises and WEFO faces a funding shortfall, it could cut grant rates or cancel some projects (paragraph 5.28).

2 Appendix

Risks to Wales gaining maximum benefit from the Structural Funds, as identified by the Auditor General for Wales in his June 2002 report

	Potential risk	Current report paragraph reference
1	Does WEFO have the staff resources to carry out its functions effectively?	2.2 - 2.4
2	Does WEFO have the information systems to carry out its functions effectively?	2.5 - 2.12
3	Are the programmes being promoted effectively?	3.12 - 3.13 (private sector only)
4	Are project applications subject to robust appraisal procedures?	3.32 - 3.36
5	Is the appraisal process too complex and time-consuming?	3.17 - 3.31
6	Is match funding readily available?	3.3 - 3.10
7	Are projects properly controlled financially?	4.2 - 4.12
8	Is monitoring of projects and the programme as a whole adequate?	4.10 - 4.23
9	Are funds being spent fast enough to avoid "decommittment"?	5.7 - 5.29
10	Are there effective evaluation arrangements?	1.5
11	Will Wales benefit from the mid-term Performance Reserve?	5.4 - 5.6