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Funding for the Wales Millennium Centre

I have prepared this report for presentation to the National Assembly under the Government of Wales Acts 1998 and 2006.

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Report presented by the Auditor General to the National Assembly on 2 October 2008

Source: Wales Millennium Centre/Kiran Ridley

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Summary

1 The Wales Millennium Centre (WMC) is an iconic building and an important part of the Welsh cultural landscape, housing seven resident organisations including Welsh National Opera. The total cost of the WMC project – £109.3 million[1] – was funded largely by the public sector (Figure 1). The Welsh Assembly Government (the Assembly Government) agreed originally to provide an annual revenue subsidy of £750,000, plus £450,000 towards long-term maintenance and capital costs, directly to the WMC, and an additional £800,000 to the five of the arts organisations that are resident at the WMC[2]. The Assembly Government also agreed to guarantee a bank loan to the WMC, initially for £10 million, later rising to £14 million, to manage a shortage of cash in the later stages of the construction.

Figure 1 - Capital funding for the WMC

Funder	£ million
Welsh Assembly Government	37.0
Millennium Commission	31.7
Arts Council of Wales	9.8
Welsh Development Agency	4.0
Other public	3.4
Other (private including capital tax allowances, donations and loan)	23.4
Total cost	**109.3**

2 Although the idea for such a building originated in the mid-1990s, it took considerable time to reach fruition, and for many years experienced uncertainty over funding and costs. In late 2000, the project was in a perilous position, with anticipated costs significantly higher than the available funding. Following redesign work and a revised procurement, the project was finally given the go-ahead by the Assembly Government in January 2002. Since opening in November 2004, the WMC has succeeded in attracting audiences in excess of one million and more than three million casual visitors – in line with its business plan forecasts. It also runs a public arts programme, including projects for children and schools, and provided free performances in its foyer. However, costs have been higher than forecast which has led to operational losses. In November 2007, the Assembly Government announced that it would pay off the loan, which had risen to £13.5 million, and increase the revenue subsidy to £3.7 million a year.

3 From its inception, the WMC was recognised as an inherently risky project: an iconic building with high capital costs and multiple funders, and an ambitious business, balancing commercial imperatives with artistic, cultural and social ambitions. We therefore examined whether the funders have

1 This figure includes the £106.2 million cost of the project as approved by the Assembly Government, plus around £3 million for additional cultural activities, the opening ceremony, and other project costs.

2 The additional £800,000 is provided via the Arts Council of Wales to five of the seven resident organisations, to cover the increased costs of occupying the building. Separate arrangements are in place for the other two residents. More details are in Appendix 1.

effectively addressed the risks involved in funding the WMC. We concluded that, in general, the funders managed the risks involved in funding the construction of the centre; but although funders examined the WMC's operational business plans and were aware of risks, these were not adequately addressed by the funders once the WMC opened. We reached this conclusion because:

- after a difficult start, the funders generally managed the risks involved in funding construction effectively;
- the funders collaborated well to monitor progress during the construction phase, but known financial risks materialised and the Assembly had to guarantee a large bank loan;
- in general, the funders were alert to the risks in the WMC's business plan, but they could have better assessed and addressed some key risks; and
- there were deficiencies in monitoring post-opening that were not addressed until the WMC requested additional public funding to avert financial crisis.

After a difficult start, the funders generally managed the risks involved in funding construction effectively

4 The WMC project emerged following the failed bid for an opera house in Cardiff Bay, and its early path to fruition was characterised by uncertainty around cost and funding. Through the late 1990s the WMC secured funding from a range of private and public bodies – including the Millennium Commission[3], the then Welsh Office[4], the Cardiff Bay Development Corporation[5], the Arts Council of Wales (Arts Council) and the Welsh Development Agency (WDA)[6] – towards a project that was estimated to cost around £70 million. However, by the middle of 2000, the project was in a particularly perilous position: the WMC had terminated its contract with a construction company after it submitted a final tender price of £86 million, significantly above the original £70 million estimate. Because of the uncertainty, the Millennium Commission suspended its funding for the WMC.

5 In October 2000, the Assembly Government provided the WMC with £2 million to redesign the building and develop greater cost certainty, and also appointed independent monitors to advise on progress. The Assembly Government's monitors reported that the need for a redesign meant there had been around £6 million of abortive costs. By March 2001, the WMC project had still not reached the level of cost certainty sought by the Assembly Government and officials had serious concerns about the level of financial risk that the Assembly Government was being asked to accept. Officials also had concerns about aspects of corporate governance at the WMC, particularly the skills mix of the Board, although the appointment of a new Chair and a new Board member from the construction industry largely addressed these concerns.

6 In April 2001, the then Finance Minister set two tests relating to the construction phase that the project had to meet in order to proceed: there had to be a fixed price procurement costing no more than £92 million; and the WMC had to make improvements to its corporate governance,

3 The Millennium Commission was wound up in November 2006 and its residual functions taken over by the Big Lottery Fund. The Big Lottery fund is subject to audit by the Comptroller and Auditor General on behalf of the UK Parliament. The Big Lottery Fund assisted us with our work, and made its files available for review.

4 Following devolution in 1998, most of the functions of the then Welsh Office were transferred to the National Assembly.

5 The Cardiff Bay Development Corporation was set up in 1987 to regenerate and redevelop the docklands area in Cardiff Bay. It was wound up on 31 March 2000 and its responsibilities were transferred to Cardiff County Council, the Countryside Council for Wales, the Vale of Glamorgan County Borough Council and the WDA.

6 In April 2006, the WDA merged into the Assembly Government.

Source: Wales Millennium Centre/Neil Bennett

specifically delegating authority to a building subcommittee of its Board. The Assembly Government's anticipated contribution to the project was £33 million.

7 In January 2002, the Assembly Government approved the project with a total price of £104 million, exceeding the £92 million ceiling announced nine months earlier. The Assembly Government's contribution had increased by £4 million to £37 million. And although there was considerably more cost certainty than had previously been the case, the contract was not entirely fixed price (although there were good value for money reasons for leaving some of the contract price subject to variation). As a consequence, officials saw that there was still a risk that the Assembly Government would be called upon for as much as £14 million more, either because of cost overruns in parts of the project where prices were not fixed, or failure by the WMC to meet its ambitious fundraising targets.

8 During the procurement process, the Arts Council's focus was on the artistic integrity of the building. It was concerned at the risk that the shift to a fixed-price procurement might result in compromises being made to quality, in particular that financial pressure on the contractor towards the end of construction might affect the quality of the fit-out of the areas which would house Arts Council-funded resident organisations. In order to manage these risks, the Arts Council sought and received assurance that the original architect was part of the construction project team, and that detailed designs for the areas to house Arts Council sponsored organisations formed part of the procurement documentation.

The funders collaborated well to monitor progress during the construction phase, but known financial risks materialised and the Assembly had to guarantee a large bank loan

9 The Welsh funders and the Millennium Commission appointed a joint project monitor in order to monitor progress during the construction of the building. This arrangement worked effectively and enabled the funders to develop a payment programme that reflected the WMC's cash flow needs during the construction phase and to avoid the risk of double payment. It also meant that all the public funders were able to monitor progress and, through detailed monthly reports, were made aware of problems as they emerged, which enabled a collective response. We see this approach as good practice in large projects where there are multiple public funders.

10 Before construction began, the funders agreed that they would 'frontload' their grants, paying more in the early months in order to give the WMC time to secure private sponsorship. However, even with this flexible cash flow arrangement, the WMC recognised that, unless it could attract a large donation at a very early stage, it would need a loan at the end of 2003, which would then be paid off as funding from other sources materialised in 2004 and the start of 2005.

11 In October 2003, the Assembly Government guaranteed a £10 million loan made by a commercial bank to the WMC. Without access to such finance, the project could not have continued. Guaranteeing the loan increased the Assembly Government's exposure to the risk that it would have to provide additional funding – up to the value of the loan guarantee – in the event of fundraising shortfalls or cost overruns. It subsequently became increasingly clear to the funders that the WMC would be unable to pay off its loan before it opened in November 2004. In November 2003, the WMC announced that it had secured a principal donor, Sir Donald Gordon, who had pledged to donate £10 million. However, this donation did not plug the immediate cash flow gap because it was spread over eight years.

12 The financial consequences of the WMC not receiving all of the funding needed before opening were compounded by increases in the total cost of the project. The WMC opened on time in November 2004, but there were cost overruns of around £5 million, largely due to increased pre-opening costs, particularly staff, administration, marketing costs and the opening gala, which cost an additional £1 million. When it opened, therefore, the WMC had to continue to rely on its existing loan. This loan, originally intended to help finance the construction phase, gave rise to servicing costs during the operational phase.

In general, the funders were alert to the risks in the Wales Millennium Centre's business plan, but they could have better assessed and addressed some key risks

13 Initially, the WMC planned to be viable without any recourse to public subsidy. The funders carried out detailed reviews of the WMC's early business plans, as they developed. Initially, Cardiff Bay Development Corporation commissioned an independent assessment on behalf of the public sector in Wales. The Arts Council also took independent advice, and the Assembly Government required the WMC to commission independent work verifying the robustness of its forecasts, and also commissioned its own assessment from PricewaterhouseCoopers (PwC). As a consequence of these reviews, the funders recognised that there was a significant chance that the WMC would not be financially viable unless it had some public revenue subsidy.

14 In April 2001, the then Finance Minister announced that the Assembly Government would provide, on an annual basis, £750,000 revenue subsidy and £450,000 for long term maintenance costs which would be paid directly to the WMC and a further £800,000 to be paid to some of the resident organisation to cover their increased costs of occupation (Appendix 1). The Finance Minister set a test: in order for the project to go ahead, the Culture Committee of the National Assembly had to be reassured that the WMC could operate within those subsidy levels. In May 2001, the WMC produced a revised plan incorporating the £750,000 subsidy. The plan was lower risk in so far as the subsidy meant that the WMC would need to attract fewer paying visitors, put on fewer performances and agree less optimistic profit sharing deals with producers in order to break-even. However, the WMC's cultural ambition had shifted, and the new plan was based on an ambitious and more costly international standard arts programme. There is nothing on record to suggest that the funders considered the financial implications of this shift in cultural ambition, and whether the previous assessments were still valid in light of this shift. In fact, the only independent review of the revised plan was carried out by the National Assembly's Culture Committee. While there were potential advantages in

securing Member scrutiny and support in this way, this was not an adequate substitute for detailed expert analysis by officials or independent advisers.

15 It is usual for complex businesses to refine their plans and, after construction began, the WMC produced revised business plans in December 2002 and October 2003, showing that the WMC would run at a loss, even after the Assembly Government subsidy. The Assembly Government and Arts Council told the WMC that it would need to produce a business plan that showed a break-even position over the first five years, but agreed that the revenue subsidy would need to be revisited in the future.

16 In July 2004, the WMC produced its final business plan before opening. This plan showed that the Centre would run at an operational loss over the first three years, but these deficits would be covered by using the Assembly Government funding for maintenance – on the grounds that the new building would require minimal maintenance in the early years – and through donations. This plan was only sustainable in the short-term, as at some point the funding for maintenance would need to be used for its intended purpose and the one-off donations were not a long term source of revenue. Further, the financial forecasts showing that the WMC would break-even did not take account of the impact of paying off the loan and associated interest charges. The Arts Council's consultants reviewed the plan and concluded that the chance of the WMC breaking even in 2005 was 'credible', but there was a high risk of the WMC incurring unanticipated deficits. At the time of opening, the funders did not assess or address the residual risks; in particular, the Assembly Government did not, as planned when the loan guarantee was first agreed, re examine the impact of servicing the loan on the WMC's business plans.

There were deficiencies in monitoring post-opening that were not addressed until the WMC requested additional public funding to avert financial crisis

17 The Assembly Government and Arts Council knew that the operational phase was high risk, and took steps to monitor performance after opening in November 2004. The Assembly Government has the main interest in WMC as the revenue and primary capital funder, guarantor of the loan, and as the main public body to whom the WMC would turn if it experienced financial difficulties. The Arts Council, although not a revenue funder of the WMC, continued to fund the companies resident there and retained an interest in ensuring that the WMC provided the artistic offering on which its capital funding had been based. Since opening, the WMC has attracted more than a million people to its performances and more than three million casual visitors, and has provided a public arts programme including projects for schools and children.

18 After the WMC opened, the Assembly Government's monitoring consisted of attending monthly WMC Board meetings as observers, meetings between WMC and Assembly Government officials as frequently as monthly, and twice-yearly meetings between the Chair of the WMC and the Culture Minister. The Assembly Government had a monitoring protocol set out in its revenue funding agreement with the WMC, which specified that detailed information on performance must be provided. However, this protocol was not agreed until two years after the WMC had opened and had been receiving revenue support.

19 Because of a misinterpretation of the Freedom of Information Act (FOIA), the Assembly Government did not keep sufficient information on the WMC's performance since opening. Although officials told us that they

could access records held at the WMC on request, we have seen no evidence that they did so. During the course of our examination the Assembly Government reviewed its interpretation of the Act and now keeps detailed information. Nevertheless, for a significant period of time, there were deficiencies in the information which the funders held about trends in the WMC's operational performance, and underlying financial wellbeing, despite a formal financial exposure of over £10 million and the expectation that the Assembly Government would be called upon for further revenue funding if the WMC did not prosper.

20 The absence of proper records within the Assembly Government, combined with staff changes within the Assembly Government's sponsor division, prevented officials from acquiring the necessary degree of understanding of the WMC's finances and therefore of the likely financial consequences for the Assembly Government. In particular, in 2005 and 2006 the Assembly Government continued to extend its loan guarantee without fully assessing whether the WMC could pay back the loan, despite the fact that the WMC was incurring much larger than anticipated losses.

21 In November 2007, following a review by consultants and an internal review of the WMC's financial forecasts, the Assembly Government paid off the WMC's loan, which had risen to £13.5 million with the Assembly Government's approval, and increased the annual revenue subsidy to £3.7 million. In assessing the revenue subsidy need, Assembly Government officials developed an improved understanding of the WMC's business and finances. They carried out a detailed assessment of the WMC's management accounts and financial forecasts prepared during 2007; they did not, however, examine the WMC's audited accounts for 2006, which were available to the public and would have provided firmer, externally verified evidence on recent financial performance.

Recommendations

1 During the early stages of the project, the funders did not have a common view of whether their priority for the construction was time, cost or quality and consequently favoured different procurement methods. Public funders of large construction projects should agree the overall priority for the public sector and the most appropriate procurement method to deliver that priority.

2 Following the Assembly Government's intervention in April 2001, the WMC adopted a fixed-price design and build contract, in line with accepted good practice where ensuring cost certainty and risk transfer are the priority. Funders should require applicants for capital funding for construction projects to demonstrate compliance with good practice, including good practice in construction identified by the Office of Government Commerce (OGC).

3 The use of the joint monitor during the capital phase was good practice, and enabled the funders to take a co-ordinated approach to addressing risks. In future, funders should use joint monitoring for all large capital projects where there are multiple funders.

4 Shortly before the project was finally approved, the WMC fundamentally revised its business ambitions, from being a regional theatre to an international arts venue. Although earlier plans had been subjected to detailed scrutiny, this revised plan was not examined in detail by officials or independent experts. Before agreeing their funding, funders should assess the impact of significant changes to business plans.

5 The transition from the construction phase to the operational phase is inherently complex and high risk, as it involves a significant shift in focus. When the WMC opened, it had a large bank loan which was guaranteed by the Assembly Government. The Assembly Government did not examine the impact of carrying over the loan on the operational viability of the WMC, nor did it develop a plan for addressing the remaining risks. As large capital projects move from construction to the operational phase, funders should identify:

- residual risks;
- how such risks could impact on the operational phase; and
- what plans are in place to manage those risks.

6 The Assembly Government did not have a revenue funding agreement with the WMC until almost two years after it opened. This delay meant that there was no binding requirement on the WMC to provide the information that the Assembly Government needed to monitor the key risks. Revenue funders should make provision of suitable information on performance a condition of their funding agreements. The level and frequency of information required should be proportionate to risk, but is likely to include:

- monthly management accounts;
- cash flow forecasts; and
- key business performance indicators.

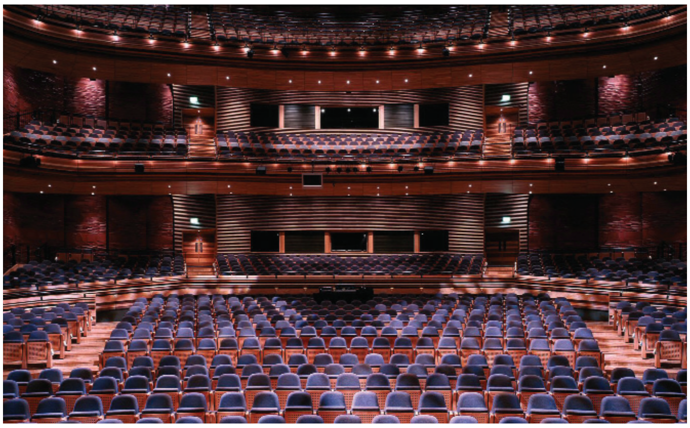
7 Because of concerns about commercially sensitive information being released under the FOIA, the funders decided not to keep detailed information about the WMC's financial and business performance. This is a fundamental misinterpretation of the how the FOIA should be applied and the funders have now reversed this decision. The Assembly Government should issue guidance to all public bodies in Wales, setting out:

- their responsibility to keep proper records; and
- that the FOIA should not be interpreted as a justification for not keeping important information and records.

8 When the Assembly Government agreed to extend its loan guarantee in 2005 and 2006, it did not have a sufficiently detailed understanding of the WMC's business. Detailed analysis would have shown that there was little prospect for it to pay off the loan, and that the ongoing interest charges further undermined the WMC's financial viability. Also, when the Assembly Government agreed to pay off the loan and increase the WMC's revenue funding, it did so after a detailed analysis of WMC business plans and forecasts but officials did not examine the audited accounts for 2006, which would have provided firmer, externally verified evidence on recent financial performance. Public revenue funders should ensure that their financial decision making is based on comprehensive information that is as robust and up to date as practically possible. The level of detail in the information should be proportionate, but is likely to include a combination of:

- audited accounts;
- cash flow forecasts;
- management accounts; and
- business plan forecasts.

Part 1 - After a difficult start, the funders generally managed the risks involved in funding construction effectively



Source: Wales Millennium Centre

1.1 There was a long-standing ambition to develop a major arts venue in Cardiff Bay, with plans for an opera house through the early 1990s, which then changed into the plans for the WMC. Building the WMC was an inherently risky project; it is a unique iconic building with multiple funders, each of which had its own priorities and ambitions. This part of the report examines whether the funders effectively addressed the risks involved in funding the construction of the WMC.

The project developed over a long period of time and there were numerous delays caused by uncertainties over cost and funding

1.2 The concept behind the WMC emerged following a failed bid for Millennium Commission funding towards an opera house in Cardiff Bay. In February 1996, a group of public sector and private organisations, including the Cardiff Bay Development Corporation and the Arts Council, met to discuss alternatives. Their discussions drew on a report by the Institute of Welsh Affairs – *Bread and Roses: making the case for a Millennium Centre for the Arts in Cardiff* (1996) – which called for a multi-arts venue in Cardiff. In 1996, the WMC constituted itself as a charity and a company to take forwards proposals for an arts venue in Cardiff Bay.

1.3 During the formative stages, the Cardiff Bay Development Corporation took a lead role for the public sector in Wales, working closely with the newly formed WMC Board and company, and the Arts Council, supported by its independent adviser, theatre consultant Louis K Fleming. The Cardiff Bay Development Corporation provided a total of £2.2 million to the WMC which it used, along with private funding including £2 million from the Garfield Weston Foundation, to support its ongoing operations and to fund professional fees for designing the building and estimating costs. Following early abortive plans that included a museum and a cinema, the WMC developed its vision for a lyric theatre – putting on opera, musicals, and dance – which would house Welsh National Opera (WNO) and six other resident organisations, and which would also incorporate retail and leisure facilities. The WMC intended that the estimated £69 million to £72 million cost of the project would be met by lottery funding – £27 million from the Millennium Commission and £10 million funding from the Arts Council, £8.5 million of which was lottery money. Both the Millennium Commission and the Arts Council made conditional offers of grant to the WMC in late 1997.

1.4 There were delays through 1998 and 1999 in securing additional funds from public bodies in Wales. In July 1999, the Secretary of State for Wales confirmed that, in addition to the Arts Council's money, £15.9 million had been allocated to the project from Welsh public sector organisations, including £8 million from the then Welsh Office and £1.5 million – later rising to £4.4 million – in European funding.

1.5 Through late 1999 and early 2000, the WMC developed its plans and, in November 1999, entered into a contract with a construction company – AMEC – to negotiate a guaranteed maximum price for construction. With a contract signed and formal commitments in place on match funding, the WMC was able to access Millennium Commission funding to develop further the plans for the site. In late June 2000, AMEC submitted its final price of £86 million; this was significantly above the £69 million to £72 million budget, and the WMC decided to terminate the contract. The WMC had an option to purchase the land on which the centre was to be built, but the option expired at the end of June 2000 and the owners, Grosvenor Waterside, indicated their intention to put the land on the open market. In order to secure the opportunity for the project to continue, Cardiff County Council purchased the land for £2.5 million[7]. Because of the uncertainty surrounding the project, the Millennium Commission suspended its payments to the WMC.

1.6 Following the termination of the AMEC contract, the Assembly Government appointed construction consultants, Turner and Townsend, to examine the likely costs of constructing the WMC. The consultants reported in autumn of 2000 that the project would cost more than £100 million. This concurred with the WMC's own assessment, and the WMC decided to embark on a process of redesigning the building with a 25 per cent reduction in size to cut costs to £82 million.

The funders were generally effective in addressing the key risks before construction

1.7 Funders continued to believe that the project offered potentially significant benefits, in terms of art and culture, Wales' international profile, regeneration and economic development from tourism, as well as offering a home to WNO and the Urdd who would otherwise have needed new accommodation at public expense. The four years spent developing the project had demonstrated that it was complex, and that there were significant challenges and risks, particularly associated with the cost of the project and what was achievable within the available funding.

7 Cardiff County Council later transferred the land to the Assembly Government at no charge. The Assembly Government retained the freehold interest and let the land to the WMC on a long lease on a peppercorn rent.

Figure 2 - Capital tax allowances

Capital tax allowances
The WMC intended to raise funds from capital tax allowances, which can be claimed against a proportion of the construction costs. Under the scheme, a bank pays the WMC for a lease of parts of the building, which the bank then leases back to the WMC. The majority of the payment is put in a high interest bank account, but the WMC keeps a proportion to use as funding for construction. The interest on the account is used to pay an annual rent charge to the bank and to repay the total lease value at the end of the lease period. The mutual benefits of the scheme are that the WMC could access cash in the short-term to fund construction, and the bank could claim capital tax allowances against the assets. The amount of money the WMC could claim from the scheme depended on the total building cost, the amount of the building the bank was prepared to lease, and on interest rates. Initially the WMC and the Treasury had differing views regarding the WMC's eligibility and the amount it could raise, but these were subsequently resolved.

Source: Wales Audit Office

The Assembly Government took reasonable steps to manage the financial risk in the project, but was still exposed to financial risk after the project's approval

1.8 Following the WMC's decision to terminate its contract with AMEC, the Assembly Government became increasingly concerned about the risks involved in the project, in particular:

- The lack of cost certainty and the risk that costs would increase after construction had begun.
- The funding gap – £8 million in private funding still needed to be raised. Officials noted that many organisations had failed to raise much smaller amounts and no organisation outside London had raised such a large sum.
- Officials questioned whether the WMC would get as much from capital tax allowances (Figure 2) as it intended.

1.9 The risk associated with cost and fundraising was a significant issue for the Assembly Government because it would be called on to make up any shortfalls if the WMC ran out of funds during the construction phase. Officials recognised that it would be very difficult for the Assembly Government to refuse to provide additional capital funding if the building was half or three-quarters constructed but ran out of money. Officials noted that the Millennium Commission would be unlikely to meet any shortfalls; the WMC was the last of the major millennium projects and the Millennium Commission would be winding down its activities during the period of construction. The Assembly Government took appropriate steps during the period from October 2000 until the approval of the project in 2002 to protect itself from financial risk. These steps comprised:

- October 2000: seeking to increase cost certainty by providing funding for detailed design work and by appointing independent monitors; and
- April 2001: requiring fixed-price procurement and demanding changes in the governance of the WMC.

1.10 Nevertheless, when the project was approved in January 2002 there remained risks of cost overruns and of funding shortfalls, either of which the Assembly Government recognised were likely to lead to calls for more money from the Assembly Government.

October 2000: improving cost certainty by providing funding for detailed design work and by appointing independent monitors

1.11 In October 2000, the Assembly Government agreed to provide the WMC with £2 million for design work intended to support more accurate cost estimates. The Assembly Government's plan was to decide whether or not to provide further funding for the project by March 2001. At the same time, the Assembly Government appointed independent quantity surveying and project management consultants – Francis Graves – to advise on progress in the WMC's revised plans and the reliability of the cost estimates.

1.12 In its interim advice provided in December 2000, Francis Graves told the Assembly Government that the WMC's decision to adopt a construction management approach to the building work meant that the project was highly unlikely to develop the level of cost certainty that the Assembly Government wished. Under the construction management approach, prices are not fixed in advance, and there is a significant reliance on a project manager to keep costs under control. The advantage of construction management is that it can allow for a shorter procurement phase, as there is no need for negotiations on the price of each piece of construction work. There is also scope for flexibility and to adapt to changes. However, the recognised risk with construction management is that, without the costs fixed in advance, they can increase significantly. Assembly Government officials told us that they were not in a position to demand a change in the procurement process at this stage; it was the third largest funder and had limited leverage over the WMC as a private company.

1.13 In January 2001, senior Assembly Government officials were concerned about corporate governance, the £6 million in abortive costs that had been incurred, and the capacity of the WMC to actually deliver the project. Officials were particularly concerned that the Board of the WMC did not have adequate experience of delivering a major construction project. At this point, Assembly Government officials seriously considered refusing to provide any further funding for the project, but resolved to continue and seek improvements in the corporate governance arrangements. Officials' concerns were partly addressed when, in February 2001, a new member from the construction industry was appointed to the WMC Board. These concerns were further alleviated by the appointment of Sir David Rowe Beddoe – the then Chair of the WDA – as the new Chair of the WMC in March 2001.

Source: Wales Millennium Centre/Alex Skibinski

1.14 Although officials took some assurance from new appointments at the WMC, there remained concerns about the financial risks of the construction project. In March 2001, Francis Graves reported that the project did not have the level of cost certainty that the Assembly Government was seeking. Francis Graves advised that the only way to secure cost certainty and transfer risk away from the Assembly Government would be for the WMC to enter into a fixed-price contract with a construction company.

April 2001: requiring a fixed-price procurement and insisting on improvements in governance as a condition of increased funding

1.15 The Assembly Government was concerned about the risks involved in the project as it stood in March 2001, but still wanted to secure the potential benefits and so made one final effort to put the project on a sound footing. In a speech to plenary in April 2001, the then Finance Minister set out two tests on construction that the project had to meet if it was to go ahead[8]:

- the WMC must negotiate a fixed-price contract with a total project price not exceeding £92 million; and
- the WMC must give clear assurances on corporate governance and delegation to the building subcommittee of the Board.

1.16 The OGC recommends that a fixed-price design and build approach is the most appropriate procurement method where cost certainty and risk transfer are the priorities. Good practice suggests that risk should rest with the party most able to manage it. As the Assembly Government recognised, in the case of the WMC construction project, the financial risk of any cost overruns would ultimately rest with the Assembly Government (paragraph 1.9). As an arms-length funder rather than the project manager, the Assembly Government would not be well placed to directly manage this risk. A fixed-price contract would transfer the risk to the construction company, which would be better placed to manage it.

1.17 One consequence of the ongoing delays in the development of the project was the loss of the £4.4 million European funding awarded to the project. To draw-down this money required significant construction expenditure by December 2001, which was no longer possible.

1.18 The £92 million cost ceiling set by the Finance Minister (paragraph 1.15) was based on Francis Graves' assessment that the project could be delivered for this price, if there was effective project management and an appropriate contract. At £92 million, the project price was higher than the original £69 million to £72 million estimate, a situation made worse by the loss of the £4.4 million in European funds. To help address the funding gap, the then Finance Minister said that, if the project went ahead, the Assembly Government would provide an additional £25 million, taking its total anticipated contribution to £33 million (Figure 3).

1.19 The then Finance Minister's speech reflected a prudent approach to the availability of the £12 million funding that had not yet been secured. She told the National Assembly that it was more reasonable to expect the WMC to raise £4 million from private donations and £5 million from capital tax allowances than its previous plans of £8 million and £7 million respectively. A supporting document to the Finance Minister's speech, made available to Members, reported that the £12 million funding to be raised represented a further potential financial risk to the Assembly Government, although she did not formally commit the Assembly Government to providing this funding if it could not be found elsewhere. Conversely, if the WMC were to exceed its private fundraising targets, the Assembly Government's contribution might be reduced.

1.20 The second requirement set by the Finance Minister, on delegation of powers to a building committee, reflected the degree of concern that the Assembly Government held about the

8 A third test was also set, on the viability of the WMC's business plan, which is reported in Part 3 of this report.

Figure 3 - Funding profile as at April 2001

Funding Source	Committed £ million	To be raised £ million	Total £ million
Assembly Government	33.1		33.1
Millennium Commission	27.0	3.0	30.0
Arts Council	10.2		10.2
Capital allowances	-	5.0	5.0
WDA	4.0		4.0
Private donations	2.9	4.0	6.9
Cardiff Bay Development Corporation	2.0		2.0
Wales Tourist Board	0.4		0.4
Other	0.3		0.3
Total	**79.9**	**12.0**	**91.9**

ability of the WMC to deliver the construction phase. The requirement to pursue a fixed-price contract reduced the reliance placed on WMC's project managers to ensure that costs remained within budget. Nevertheless, it was prudent for the Assembly Government to use its financial leverage to assure itself that appropriate authority to manage the construction phase was invested in a WMC subcommittee where there was a concentration of individuals with skills and experience in managing large building projects.

January 2002: project approved but Assembly Government still exposed to financial risk

1.21 Between April and December 2001, the WMC invited tenders, selected a preferred bidder and negotiated a contract with Sir Robert McAlpine Ltd for the construction of the WMC. It quickly became apparent that the WMC would be unlikely to negotiate a total project price of £92 million, the maximum specified by the Finance Minister. In August 2001, the Finance Minister agreed to increase the Assembly Government's anticipated contribution further, from £33 million to £37 million, but told the WMC that no further money would be provided and any further funding would have to come from other sources. In December 2001, the WMC and Sir Robert McAlpine reached agreement on a price for the construction of £78 million, which took the total project price to £104 million, including previous expenditure and operational costs. Figure 4 shows that, in addition to the extra money promised from the Assembly Government, the main source of additional funding to cover the higher price was £5.6 million in private funding. The WMC planned to raise a further £2 million from the capital tax allowances, based on a conditional agreement with its bank, Lloyds TSB Leasing Ltd.

Figure 4 - Funding profile in December 2001

	April 2001 £ million	Increase £ million	December 2001 £ million
Assembly Government	33.1	3.9	37.0
Millennium Commission	30.0	0.7	30.7
Arts Council	10.2	(0.4)	9.8
Private (to raise)	4.0	5.6	9.6
Capital tax allowances	5.0	2.0	7.0
WDA	4.0	-	4.0
Private (committed)	2.9	-	2.9
Cardiff Bay Development Corporation	2.0	-	2.0
Wales Tourist Board	0.4	-	0.4
Other	0.3	0.4	0.7
Total	**91.9**	**12.2**	**104.2 (after rounding)**

Source: Wales Audit Office analysis

1.22 The final project met the Finance Minister's requirement on delegating authority to the WMC's building committee, but it did not fully meet the Finance Minister's test that the project must be fixed price and cost no more than £92 million. At £104 million, it clearly breached the £92 million cost ceiling. And the Assembly Government had agreed to pay more than the limit the Finance Minister had previously set for its total contribution.

1.23 Although the major part of the contract with Sir Robert McAlpine was at a fixed price, elements of the project, such as fixtures and fittings and IT, were not at fixed prices. The Assembly Government recognised that it would be uneconomical for the WMC to pay the premium needed to transfer these risks to the contractor. Officials considered that, based on a report by Francis Graves, there were some £15 million of unfixed costs which could overrun, although there was some contingency within the WMC's budget[9]. Although there was more cost certainty than under the previous construction management approach adopted before April 2001 and there was a transfer of risk away from the Assembly Government, there was still a risk that costs would exceed the £104 million total project price.

1.24 Officials also identified financial risks in the funding profile for the construction of the centre. In April 2001, the Finance Minister had stated that £4 million would be a prudent fundraising target but, in order to fund the

9 There was also a risk of cost overruns related to the provision of car parking, which was a condition of the WMC's planning permission, although this was not part of the construction contract.

Figure 5 - Assembly Government financial exposure

	April 2001 £ million	January 2002 £ million	Increase £ million	Note
Firm Assembly Government contribution	33.1	37.0	3.9	
Officials' considered view of level of residual risk to Assembly Government	12.0	14.0	2.0	Assembly Government files do not record how the figure of £14 million was derived from the various elements of risk set out below
Total potential financial requirement	**45.1**	**51.0**	**5.9**	
Sources of funding at risk				
Additional Millennium Commission funding	3.0	N/A	N/A	£30.7 million in Millennium Commission funding already agreed by January 2002 (paragraph 1.27) – no longer a risk
Private donations to be raised	4.0	9.6	5.6	
Capital tax allowances to be secured	5.0	7.0	2.0	By January 2002 a degree of assurance had been provided by the bank (paragraph 1.21)
Total funding at risk	**12.0**	**16.6**	**4.6**	

Note

In addition, £15 million in the project was not fixed; the Assembly Government was potentially exposed to the risk that these costs might rise.

Source: Wales Audit Office

higher contract price, the target had increased substantially to £9.6 million. There was no new evidence that this additional funding could be secured, and Francis Graves' advice was that it was an ambitious target. However, officials took comfort from the new Chair of WMC's background in seeking greater private sector investment, and concluded that they did not have grounds for saying the target could not be achieved. In our view, it is unlikely that such grounds could ever be found and, as officials recognised, there was a risk that if the target was not achieved, the Assembly Government could be called on to bridge any shortfall.

1.25 Officials quantified the level of residual risk – relating to both the possibility of cost overruns and shortfalls in private funding – and concluded that, at worst, the Assembly Government could be called upon to provide an additional £14 million to the project. Figure 5 shows how the total financial risk to the Assembly Government had increased between April 2001 and January 2002.

1.26 Officials recommended that the then Culture Minister should give the project final approval on 'the clear understanding that you and your colleagues are aware of these risks and their possible consequences for the Assembly if

The Assembly Government contribution and the project test

Officials advised the then Culture Minister that 'the project fails one of the tests because the overall project price is significantly higher than the ceiling set then [by the Finance Minister]. But … the project intends to fund the difference from other sources. The additional £37 million Ministers agreed to set aside for the project should they be required is within the ceiling set by the Finance Minister'.
The £4 million additional contribution from the Assembly Government, taking its firm commitment from £33 million to £37 million, however, was arguably outside the parameters established by the Finance Minister. The additional £12 million exposure referred to by the Finance Minister was to cover any shortfalls in unsecured funding from other sources. As Figure 4 shows, the additional £4 million pledged by the Assembly Government in January 2002 was not for this reason but rather to cover, in part, increased total project costs. And the amount sought from these other sources of funding had actually increased, rather than decreased.

they materialised'. Officials' advice was also copied to the then Finance Minister. In January 2002, when the National Assembly was asked to vote to welcome the imminent signing of the contract, the Culture Minister reported that the project had met the tests set for it by the Finance Minister in April 2001 – see box below. Although the Culture Minister reported that some risks remained, she did not provide a detailed assessment of the nature, scale and potential impact of those risks. The National Assembly for Wales subsequently voted to welcome the project, including the £37 million contribution by the Assembly Government.

1.27 Shortly before the vote in plenary, the Millennium Commission wrote to the Assembly Government, to confirm that it was prepared to provide its £30.7 million funding. However, it expressed concern at the risks associated with the project not being entirely fixed price, and the level of private funding that needed to be raised. The Millennium Commission reported that if these risks materialised it would not be prepared to increase its grant.

The Arts Council was particularly concerned about risks to the quality of the building and sought to mitigate these risks before construction started

1.28 The Arts Council had been involved in the WMC project from its inception, and approved its funding to the Centre in November 1997. In addition to appointing an independent consultant, Louis K Fleming, to advise on the progress in developing the plans for the centre and the attendant risks, the Arts Council also shared a joint project monitor with the Millennium Commission – the WT Partnership – to advise on costs. The Arts Council endorsed the WMC's decision in summer 2000, following the termination of the AMEC contract, to adopt a construction management procurement method.
In October 2000, the WT Partnership had participated in a procurement workshop held by Citex, the WMC's project managers, which endorsed the construction management approach, and the Arts Council had confidence in Citex to manage the construction phase and deliver it within budget.

1.29 The Arts Council's preference for a construction management approach reflected its focus on the artistic integrity of the design and the quality of the building, which could be put at risk in a fixed-price contract. Arts Council officials were mindful of the Arts Council's role in protecting the artistic vision for the WMC, and, for example, insisted that acoustic experts should have a significant input into the design of the theatre. The Arts Council wrote to the WMC in May 2001 expressing concern about its decision to seek a fixed-price contract (paragraphs 1.14 – 1.16 and 1.21). The Arts Council identified the risk that if costs rose and profit margins were squeezed, the contractor might seek to compromise the quality of the final fixtures and fittings in the residents' areas, which would impact on their ability to make best use of the space. In order to mitigate this risk, the Arts Council sought, and received, assurances from the WMC that existing specifications for those areas would form part of the procurement documentation. The Arts Council recognised that this would be an area that it would need to monitor closely through the actual construction period. The Arts Council also sought to mitigate the overall risk to quality by insisting that the original architects who designed the building – Percy Thomas Partnership – would be part of the fixed-price design and build team.

The WDA carried out its own risk assessment of the project, but relied on other funders to manage the key risks

1.30 For its part, the WDA's involvement in the project was minimal. In October 1997, the WDA wrote to the WMC stating that it would consider contributing up to £4 million to the WMC, subject to further assessment and availability of funds. However, before the WDA Board had formally approved the project, in June 1999 the then Secretary of State for Wales announced that the funding was in place. Welsh Development Agency officials expressed some concern that expenditure on the WMC did not fit with the WDA's corporate aims and plans to focus investment in the Objective One areas, which did not cover Cardiff Bay. Nevertheless, in July 1999, the WDA Board gave approval for the project, subject to the Chief Executive receiving further assurances on cost and operational viability. In June 2000, WDA officials became aware that the WMC was having difficulty reaching an affordable agreed price with AMEC, and that there was a serious risk that Grovsenor Waterside would put the land on the open market. As a consequence, the WDA decided that it would not consider any application for release of funding until the project was secure and viable.

1.31 There is little on the WDA records covering the period from the middle of 2000, when the WMC terminated its contract with AMEC, to January 2002, when the WMC agreed the contract with Sir Robert McAlpine. Once the Assembly Government had agreed to support the project in January 2002, the WDA commissioned legal advice from Eversheds, which advised that the project was not entirely fixed price, and not all risk was transferred to the contractor and there was therefore a risk that the total price might increase. In March 2002, just a few days before formal approval was given by the Chief Executive, WDA officials carried out a risk assessment, which identified a number of outstanding risks, including:

- failure to raise private sector funding;
- WDA's contribution does not sit particularly comfortably with its aims; and
- cost overruns.

1.32 The WDA risk assessment concluded that: 'the Agency's support for the venture is high risk'. The WDA sought to rely on other funders to ensure that the identified risks were managed, and wrote into its grant agreement a clause stating that in making any claims for payment from the WDA, the WMC was asserting the other funders were content with the construction plans and progress. In part, this reliance on other funders reflected the WDA's view that because funding for the WMC did not fit neatly with its corporate aims, it would not be expected to provide further money. In the WDA's view the Millennium Commission, Arts Council, and Assembly Government would be more exposed to risk, and would be best placed to manage those risks.

Part 2 - The funders collaborated well to monitor progress during the construction phase, but known financial risks materialised and the Assembly had to guarantee a large bank loan

Source: Wales Millennium Centre/Phil Boorman

2.1 In spring 2002, work on constructing the WMC began. There are particular challenges for public sector bodies funding an independent organisation to build high profile buildings. The WMC had multiple public funders, and this part of the report examines whether they effectively monitored progress during the construction phase, and whether that enabled them to address any risks to their realising the intended benefits of their investment.

The joint monitoring arrangements exemplified good practice for projects with multiple funders

2.2 When they agreed to fund the project, the funders knew that there were significant risks remaining in the project, and that they would need to monitor progress closely. Following the signing of the construction contract in February 2002, the Assembly Government, Millennium Commission and Arts Council agreed that they would appoint a new joint project monitor to provide a detailed oversight of the project's progress through the construction phase, and to verify the WMC's claims for release of grant funds. In February 2002, the three funders appointed construction consultants, Northcroft, to carry out the role. In October 2002, the WDA also appointed Northcroft to act as its project monitor. This arrangement was very effective, and is an example of good practice for other projects where there are multiple funders. In particular, the benefits of the joint monitor approach were:

- All funders had the same detailed information about progress – the project monitor compiled a monthly report showing progress in constructing of the building itself, fundraising, progress in reaching a solution on the car park, and business planning issues. These reports alerted funders to any actual or possible problems and what remedial action was being taken.

- The funders met on a monthly basis to discuss progress based on the detailed information, although the WDA did not attend these meetings on a frequent basis. At these meetings the funders were able collectively to press WMC staff on progress in key risk areas.

- Joint monitoring minimised the risk of different funders paying for the same elements of construction – procurement regulations require that, before they can release their grant payments, funders have proof that the project has actually incurred the expenditure. In such complex projects as the WMC, there is a risk that different funders can end up funding the same expenditure.

2.3 The nature of the construction meant that the WMC's expenditure would not be regular; it would need to spend more in some months than others, as different pieces of work were completed. The WMC's early forecasts showed that it would need a higher amount of cash from the public sector over the first year because it needed time to organise its fundraising and secure funds from the private sector, and the bulk of the revenue from the capital allowance scheme would not come through until the late stages of construction. The Assembly Government, Arts Council and Millennium Commission agreed that they would be flexible and frontload their payments, so that the monthly release of funds would be higher over the first year.

By agreeing to guarantee the Wales Millennium Centre's bank loan, the Assembly Government formally accepted the risk that it might have to fund any shortfalls

2.4 Although the funders agreed to frontload their payments, they knew that the WMC would still face a cash shortage from October 2003 unless it could secure private sector funding much more swiftly than it had planned to. The main cause of the cash shortage was that funding from the capital allowances would not be received until the very late stages of construction. Before construction began, the WMC reported that it might need to take out some form of loan and, in doing so, would need assistance from the funders; under the capital tax allowance arrangements, much of the building would be leased so it could not be used as security for a loan. The Assembly Government responded that it would do what it could to help the WMC if it could not resolve the gap in its funding. In February 2003, the WMC told the Assembly Government that it would need a £10 million loan to complete the construction.

2.5 In June 2003, the Assembly Government agreed that it would guarantee a commercial bank loan and, in line with the National Assembly's Standing Orders, informed the National Assembly of the contingent liability[10]. At this point, the WMC's cash flow forecasts showed that if it met its fundraising targets it would be in a position to pay the loan off shortly after the WMC opened (Figure 6). The Assembly Government did not examine the option of itself providing the WMC with a loan.

2.6 By the time the loan guarantee was agreed with HSBC Bank in October 2003, the WMC cash flow forecasts showed that its peak borrowing requirement would be £9 million, which took it close to the loan guarantee limit of £10 million. The bank sought and received assurances from the First Minister that the Assembly Government understood the risk that, in a worst case scenario, HSBC might need to take action to recover the entire loan, even if it exceeded the total guarantee. When the guarantee was signed, the WMC still intended to pay the loan off in full, shortly after it opened, with money it planned to raise from fund-raising. However, this was becoming more challenging: the WMC had begun to fall behind in its fundraising strategy, and costs had begun to rise. The Assembly Government therefore recognised that there was a likelihood that the loan might not be paid off, and identified three options, where such a scenario to materialise:

10 A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control.

Figure 6 - Capital cash flow forecast, May 2003

	Pre-2002 £000	2002 £000	2003 £000	2004 £000	2005 £000
Outflow	14,293	24,625	44,342	22,158	-
Inflow	15,029	26,432	37,497	24,530	1,131
Annual surplus/(deficit)	743	1,807	(3,831)	157	1,131
Cumulative net cash position	743	2,543	(1,288)	(1,131)	0

Note

These figures are for the capital cash flow only, and do not include planned income and expenditure from the operations of the WMC after opening.

Source: Wales Audit Office

- require the WMC to pay the loan off over the longer term through its operational income with no Assembly Government assistance;
- provide a capital injection to pay off the loan in full; or
- provide additional revenue funding so that the WMC could pay the loan off through instalments.

The Wales Millennium Centre was built on time, but cost increases and funding shortfalls meant that the Assembly's exposure to risk against the Wales Millennium Centre's loan was extended beyond the construction phase

2.7 The WMC opened on time in November 2004 and the total cost of the project was £109.3 million; £5 million over the original budget (Figure 7). The funders were fully aware of the revised cost estimates throughout the construction. In December 2001 the WMC revised the total cost estimate to £105.3 million due to increased legal fees and operational costs caused by some early delays in starting the construction work. In October 2003, this was revised again to £106.2 million, the increase being primarily due to rising staff and marketing costs. The Assembly Government told the WMC that it was not prepared to increase its contribution and these increases would have to be met from its private fundraising. In May 2004, the WMC informed funders of an additional £2 million that would be required for further pre-opening costs associated with the opening gala, the WMC's public arts programme, and interest charges. During the final stages of construction, a further £1 million was added to cover additional administration and building costs.

2.8 Although the cost overruns were quite small relative to the overall scale of the project, they meant that the WMC needed to secure additional private funding, on top of the already challenging £9.6 million target set at the outset. Fundraising was a standing item at the joint monitor's meetings, and the minutes of the meetings show that the funders regularly pressed the WMC on progress against its fundraising milestone targets.

Figure 7 - Cost overruns

	Budget £ million	Final cost £ million	Difference £ million
Construction and building work	97.6	98.2	0.6
Staff and administration	4.6	6.5	1.9
Interest charges	0	0.6	0.6
Business development, marketing and PR	1.3	1.8	0.5
Cultural ambition (including public arts and opening gala)	0.7	2.3	1.5
Total	**104.2**	**109.3**	**5.1**

Source: Wales Audit Office

The WMC provided regular updates on its fundraising activity and efforts to attract sponsorship, but reported that, because of economic circumstances, it was increasingly difficult to secure donations. When the Assembly Government agreed to guarantee the loan in October 2003, the WMC was falling behind its targets, having raised around £1 million against its plan to have raised £2 million by that point. Funders recognised that not only were the economic conditions challenging, but that the window of opportunity for fundraising was shrinking; with opening approaching, it was increasingly likely that donors would look to sponsor particular productions, rather than the construction. The Arts Council's adviser had reported that it is extremely rare for projects to raise capital funds after the construction phase has been completed.

2.9 In November 2003, the WMC secured the promise of a £10 million donation from its principal donor, Sir Donald Gordon. However, the donation was to be paid over eight years, with the money to be split between capital and revenue, and therefore did not address the immediate cash flow needs. By May 2004, the WMC was increasingly reliant on its bank loan to finance construction work and cash flow forecasts no longer showed the loan

Figure 8 - WMC capital cash flow forecast May 2004

	Pre-2002 £000	2002 £000	2003 £000	2004 £000	2005 £000
Outflow	14,293	24,625	37,186	30,016	-
Inflow	15,029	26,432	31,998	25,409	4,911
Annual surplus/(deficit)	736	1,807	(5,188)	(4,606)	4,911
Cumulative net cash position	736	2,543	(2,645)	(7,252)	(2,341)

Note

These figures are for the capital cash flow only, and do not include planned income and expenditure from the operations of the WMC after opening.

Source: Wales Audit Office

being paid off (Figure 8). In July 2004, the Assembly Government agreed to increase its loan guarantee to £14 million to match the WMC's short-term cash needs.

2.10 By the end of the construction phase, the gap between committed capital funding and the project cost had been reduced to £2.3 million, partly thanks to an additional £1 million provided by the Millennium Commission. However, £11 million of this committed capital funding was yet to be received (Figure 9) and this gap was bridged by the loan. This meant that the WMC entered the operational phase with a large loan. Therefore, the Assembly Government's exposure to the risk that it would be required to pay off all or some of the loan was carried over beyond the construction phase. The servicing of the loan has had a significant impact on the financial viability of the WMC, as Part 4 of this report demonstrates.

Figure 9 - Capital funding position at the end of the capital phase

	£ million	£ million
Total project cost		109.3
Secured public funding and donations received		98.3
Capital funding not yet received at end of capital phase		11.0
Funding to be received in 2005		
Assembly Government	1.8	
Millennium Commission	1.0	
Arts Council	0.4	
WDA	0.1	
Principal donor	3.6	
WNO	0.8	
Urdd	0.3	
Cardiff Harbour Authority	0.3	
HSBC – opening weekend contribution	0.2	
Cardiff County Council	0.1	
Total		**8.6**
Funding Gap (to be funded from future principal donor funding)		**2.3**

Source: Wales Audit Office

Part 3 - In general, the funders were alert to the risks in the Wales Millennium Centre's business plan, but they could have better assessed and addressed some key risks

3.1 As well as constructing an iconic building, the WMC also planned to run a successful operational venue, attracting paying audiences to performances in its theatres. The viability of the operational phase can be the most financially high risk aspect of a project, and when things do not go as planned, the public sector can end up having to provide revenue subsidies that far exceed cost of construction over the long-term. This part of the report examines whether the funders effectively assessed the risks involved in the operational phase of the WMC.

Funders assessed the Wales Millennium Centre's early business plans and had doubts about its ability to operate without a revenue subsidy

3.2 As would be expected with any complex business, the WMC's business plans evolved since the project was first conceived. Before starting construction, funders examined a number of business plans, notably plans produced in February 1999 and September 2000. The WMC's early business plans showed that it intended to be self-financing with no revenue funding from the public sector. In mid-2000, at the Assembly Government's request, the Board of the WMC made a statement of intent that it would not call on the public sector for revenue subsidy.

In assessing viability the Assembly Government sought to implement lessons learnt from other high profile projects

3.3 When the Assembly Government provided the WMC with funding for redesign work in October 2000 (paragraph 1.11), it required the WMC to carry out further work to demonstrate the viability of its business plan (dated September 2000) – Figure 10. In setting these conditions, the Assembly Government was, commendably, seeking to learn from audit work on other high profile projects, particularly the Millennium Dome, where visitor numbers and revenue forecasts had been very optimistic. Between September 2000 and March 2001, the WMC commissioned a number of reviews of its business plan:

- Arts consultants, M&C Saatchi Arts, reviewed audience forecasts and concluded that the realistic attendance figures would be 432,000 a year, rising to 488,000 if the centre could attract top quality performances. It also concluded that a further 350,000 visitors could be attracted to other events/facilities in the building.
- Comparative research by theatre consultant Graham Devlin identified risks associated with the market for large-scale musical productions, concluding that the WMC ticket prices would be competitive, and that staffing and overhead cost levels were in line with comparators.
- Auditors, KPMG, carried out a risk review which identified and ranked high level risks in both the construction and operational

phases and set out actions the WMC could take to mitigate risks.

Figure 10 - Summary of the WMC's September 2000 business plan

	2004 £000	2005 £000	2006 £000
Operational income	3,207	3,193	3,308
Operational expenditure	3,172	2,992	3,106
Profit/loss	35	202	202

Source: Wales Audit Office

3.4 In April 2001, the Assembly Government commissioned PwC to review the WMC's September 2000 business plan. It was not part of this assignment for PwC to verify independently the forecasts made by WMC management in the business plan. PwC identified a number of risk areas (Figure 11) in the WMC business plan. PwC also carried out a sensitivity analysis, testing the impact of any changes in the business plan forecasts. These showed that if some of the identified risks materialised, the WMC could face an annual operational deficit of up to £500,000.

The Arts Council examined the September 2000 plan and was particularly concerned about the possibility of unexpected deficits and the impact on the resident organisations

3.5 The Arts Council examined the WMC's business plans at various stages in the early years. In particular, the Arts Council examined in detail the WMC's September 2000 business plan, and challenged the Chair and Chief Executive of the WMC on the underlying assumptions at a meeting in February 2001. In March 2001, the Arts Council wrote to the Assembly Government

Figure 11 - Summary of PwC assessment of the WMC's September 2000 business plan

Risk area	Identified risk
Market risk	■ competition for leisure time; ■ Cardiff Bay was an untested venue, outside city centre area; ■ fundraising – market saturation, and programme sponsorship usually goes to producers, not host venue; and ■ retail – may need to enter incentive agreements and increased rents may be hard to achieve.
Programme risks	■ 270 performances would be a challenge given that WNO occupies the main stage for 18 weeks but gives just 30 performances (see box below); ■ musicals particularly challenging, the WMC would need to attract audiences 3.5 times those attending musical at the New Theatre in Cardiff; ■ changes in the market for musicals might result in less favourable terms; ■ the WMC would need to attract 20 times the audience for dance/ballet at the New Theatre – might prove challenging; and ■ in conclusion, considerable growth in the local market would be required and projections for musicals appeared particularly challenging.
Product risks	■ increase in capital costs, which might need to be funded through private sector loans; and ■ car park – could lead to an increase in capital costs and require revenue support if no private sector partner were found.
Financial risk	■ High risk income streams identified by PwC: - Musicals; - Pantomime; - recharges to production companies for technical staff and operational costs; and - sponsorship.

Welsh National Opera and the ‘dark nights’

The need to find a new home for the WNO was one of the original drivers behind the concept of the WMC and a significant factor in it attracting capital funding. The popularity of performances by the WNO at the WMC (see Appendix 1) is evidence of the success of the collaboration between the two parties. However, one of the key areas of financial risk identified in every assessment of the WMC business plan has been the loss of income for the WMC arising from the WNO’s need to use the theatre for rehearsals. Business plans forecast that there would be up to 90 such ‘dark nights’ each year when the WMC could not put on performances. Although WNO had agreed to compensate the WMC for the use of the stage, this compensation was significantly lower than the WMC’s predicted average nightly revenue from productions and retail (because fewer people would be visiting the building on the dark nights). To some extent this issue has now also been addressed by additional Assembly Government revenue funding made available to the WMC in 2007 (paragraph 4.18). The WNO has now agreed to reduce the number of dark nights it requires from 90 to 70 a year, and discussions on the funding implications for the WMC are continuing (paragraph 4.22).

expressing concern that:

- there were as yet unknown financial consequences for the Arts Council funded residents, in particular:
  - service costs; and
  - costs of delivering the WMC’s planned public arts programme
- there was a shortage of high quality productions, in particular musicals; and
- marketing and staffing budgets seemed very lean.

3.6 The Arts Council was particularly concerned about the impact of any unanticipated deficits and told the Assembly Government it was concerned about the adequacy of the WMC’s contingency plans. The Arts Council said that it was ‘clear that significant subsidy will be required on an ongoing basis’.

3.7 In March 2001 the Arts Council’s external adviser, Louis K Fleming, reviewed the September 2000 plan and identified a number of risks:

- unless the WMC could provide adequate parking, it would struggle to attract sufficient visitors;
- the underlying research for the WMC’s forecasts was sound, but account should have been taken of demographic factors – particularly income and education – as these might have shown a smaller market for the WMC; and
- the marketing budget might have been understated; if visitor numbers were not achieved, more marketing would be needed.

However, the Arts Council did not examine the revised May 2001 business plan to test whether the identified risks had been addressed.

The WDA did not assess any plans for itself, has none on record and relied on other funders to assess operational risks

3.8 The WDA did not independently assess any of the WMC’s business plans, and has generally relied on other funders for assurance as to the Centre’s long-term viability. The paper put to the WDA Board in July 1999, seeking approval for funding the project reported the findings of an assessment by accountants BDO Stoy Hayward, including the possibility that the centre could incur an annual operating deficit of around £450,000. The Board approved funding the project subject to securing further assurances on long-term viability. However, there are no records of any such assurances being given, and the WDA’s records show that, when they agreed to fund the project, WDA officials were not vouching for the viability of the business plan. The WDA has

made other funders' acceptance of the long-term viability of the WMC operations a condition of its grant agreement with the WMC, requiring the WMC to accompany requests for payment with confirmation that the other funders are content with the business plan.

Funders' assessments did not focus sufficiently on operating costs

3.9 The assessments carried out and commissioned by the funders tended to focus on testing the reliability of the income forecasts, rather than overhead costs. This reflected the funders' intention of learning lessons from other high profile projects where audiences and income forecasts had been over-optimistic. The WMC itself commissioned work in late 2000 on estimating the costs of facilities management, which informed its business plan and which was shared with the Assembly Government as evidence that it had considered the whole-life costs of the building. The comparative research carried out by theatre consultant Graham Devlin for the WMC in early 2001 reported that forecast overhead and staffing costs were in line with those at Birmingham Hippodrome. In its report to the Assembly Government, PwC said that service cost estimates were high risk as they were based on historic figures, but that staff costs seemed reliable.

Revenue funding to the Wales Millennium Centre and the residents addressed some risks, but funders did not fully assess the financial implications of changes to the Wales Millennium Centre's cultural aspirations

3.10 In March 2001, the WMC requested that the Assembly Government provide £750,000 to support an enhanced international standard programme at the centre, and additional public programme activities. The case for the enhanced programme was set out in a WMC paper, which outlined the centre's revised 'cultural ambition', and explained that the previous business plan had been based on the kind of programme quality that is found in regional theatres around the UK. The enhanced programme would involve higher quality, internationally renowned productions being put on at the WMC. The paper estimated that this enhanced programme would cost £750,000 more than a regional theatre standard programme.

3.11 In April 2001, when updating the Assembly on the progress of the project (paragraph 1.15), the then Finance Minister told the Assembly that if the project went ahead, the Assembly Government would provide annual funding towards the project, made up of:

- £750,000 revenue support to the WMC;
- £450,000 to the WMC towards a 'sinking fund' to support long-term maintenance costs; and
- £800,000 paid via the Arts Council to some of the residents in order to meet the extra costs of occupying the centre.

3.12 In addition to the two tests on construction (paragraph 1.15), the Finance Minister set a third test: in order for the project to go ahead, the Culture Committee had to be reassured that the project could operate within the revenue subsidy settlement outlined above.

3.13 Following the Finance Minister's speech, the WMC developed a new plan, which was sent to the funders in May 2001. The revised plan included the £750,000 revenue from the Assembly Government and envisaged less theatre income, and less ambitious profit sharing arrangements with producers, in order to break-even (Figure 12). There is no evidence on record that the funders evaluated the impact of the revisions to the plan, in particular the WMC's intention of delivering an enhanced and more costly international arts programme. In April 2001, PwC had advised that an international arts programme would require a revenue subsidy, but did not offer an opinion on what level of subsidy would be required. Comparative research - by theatre consultant Graham Devlin - that informed the WMC's previous business plans (paragraphs 3.3 and 3.9) had been based on comparing the WMC's business plan forecasts with the experience of regional theatres across the UK. The funders did not examine whether those comparisons were still valid for an international arts venue.

3.14 Assembly Government officials told us that decisions on whether or not to commission a formal analysis of changes to WMC's business plan would have been coloured by the evidence already available from earlier studies and the WMC's view as to whether the revenue funding was sufficient. However, the May 2001 plan reflected a significant shift in the WMC's cultural ambitions and was the final opportunity for a detailed re examination of the plan's viability in light of the changes, before construction began. The only detailed analysis of the May 2001 plan was carried out by the Culture Committee of the Assembly, in line with the test set out by the Finance Minister. In her speech the Finance Minister recognised that the members of the Culture Committee were not experts in assessing business plans, but noted that they had been robust and tenacious in scrutinising plans to date. In May 2001, the Culture Committee examined the plan and questioned the Chair of the WMC and staff on the detail of the plan. Later that month, the Committee told the Culture Minister it was satisfied that the business plan was reasonable. It is unusual for an Assembly committee to provide the only independent examination of a business plan for such a complex project. While there were potential advantages in securing Member scrutiny and support in this way, this was not an adequate substitute for expert detailed analysis by officials or independent advisers.

Figure 12 - Comparison of year one forecasts in the September 2000 and May 2001 business plans

	September 2000 plan	May 2001 plan
Theatre income	£6.5 million	£6.0 million
WMC share of theatre income	28%	18%
Audience numbers	414,000	338,000
Surplus/(deficit)	£22,000	£30,000

Source: Wales Audit Office

When the project was approved, the Assembly Government knew that there was a risk that the Wales Millennium Centre would need further revenue support in future

3.15 In January 2002, before the project was approved, officials advised the then Culture Minister that there was a risk that the WMC would need further revenue support in the future. Officials reported that, as required by the Finance Minister's test, the Culture Committee had reassured itself as to the soundness of the business plan. Officials also advised the Culture Minister that the business plan had been subject to independent reviews by PwC and by consultants for the Millennium Commission, although they did not state specifically that these were reviews of earlier versions of the plan, nor did they explain that PwC had not independently verified the management forecasts (paragraph 3.4). When the National Assembly for Wales voted in plenary to welcome the project in January 2002, the Culture Minister referred in general to the risks of visitor numbers, citing the example of the Centre for Visual Arts in Cardiff[11], but did not draw detailed attention to the specific risk that the WMC might need more revenue support. The Culture Minister reported that the Culture Committee was reassured of the soundness of the business plan and referred to the two independent reviews, but did not report that these were reviews of earlier versions of the plan or that the WMC's forecasts had not been reviewed.

Funders did not have a collective approach to addressing the Wales Millennium Centre's revisions to its business plan once construction began

3.16 After construction began, the funders, particularly the Arts Council, put pressure on the WMC to refine its operational business plan. In December 2002, the WMC produced a revised plan, which showed an annual operating deficit of almost £600,000 after the £750,000 Assembly Government revenue subsidy. The Arts Council's independent adviser, Louis K Fleming, examined the plan and concluded that the annual revenue subsidy would need to be increased. The funders discussed the plan at the joint monitoring meeting in March 2003, but by this point, the WMC had appointed a new Chief Executive, who had previously worked in Sydney Opera House, and funders agreed to wait and see what impact her ideas would have on the plan.

3.17 In October 2003, the WMC produced a new business plan showing a deficit forecast of £1.4 million, after the £750,000 Assembly Government revenue subsidy. The Arts Council and the Assembly Government had different ideas as to how to respond to this plan. The Assembly Government wanted to manage down the WMC's ambitions, and tell the WMC that it would not provide any further revenue support. The Assembly Government's approach was to demand that the WMC produce a new business plan that broke even within the allocated levels of revenue subsidy. Officials explicitly ruled out commissioning an independent review, unless the terms of reference involved supporting the WMC to develop a business plan that broke even.

11 Auditor General, November 2001, Arts Council of Wales: Centre for Visual Arts

3.18 At the same time, the Arts Council, in line with its standard procedures for capital projects, appointed a team of independent arts consultants to review the business plan. The consultants concluded that the projected £1.4 million deficit might be severely underestimated and significantly more revenue subsidy may be required, possibly as much as £3 million. The consultants examined the cultural ambitions and concluded that any reduction in the proposed high quality programme to achieve its mission would have a detrimental artistic and financial impact. The findings of the report were discussed with the Assembly Government.

3.19 Following detailed discussions with the Assembly Government, Arts Council and consultants, the WMC agreed that it would produce a new plan showing a break-even position over the first five years. This plan would then be reviewed by the consultants. The funders recognised that achieving a break-even position would be optimistic; the Arts Council considered that further revenue from the Assembly Government would be required after just two years, and the Assembly Government and Arts Council agreed that the revenue subsidy would need to be revisited in the future.

The funders knew the Wales Millennium Centre's final business plan was high risk, but were not sufficiently alert to remaining financial risks as the Centre moved towards opening

The Assembly Government and the Arts Council agreed to a high risk final business plan that was subjected to adequate independent scrutiny but was only sustainable in the short-term

3.20 In July 2004, the WMC produced its final business plan before opening, by which time the programme was booked and there was little scope for funders to influence or change the plans. The plan showed that the WMC would run at an operational loss of £1.2 million in its first year, which would reduce to £0.5 million in Year 3 – Figure 13.

Figure 13 - WMC July 2004 business plan

	Year 1 £000	Year 2 £000	Year 3 £000
Income	3,544	3,995	4,240
Expenditure	4,733	4,755	4,769
Profit/loss	(1,189)	(760)	(529)

Source: Wales Audit Office

3.21 The WMC planned to fund these operational losses by using the £450,000 sinking fund, provided by the Assembly Government to cover maintenance costs, as revenue support. It also planned to use part of the principal donor's funding and another one off donation to reach a break-even position. Clearly this funding position would not be sustainable in the longer term; the sinking fund would need to be used for maintenance as intended, and

Source: Wales Millennium Centre/John Evans

the principal donor's money would run out. The reduction in deficit over time would depend on the WMC raising much higher levels of private sector donations – up to £1 million by Year 3. In April 2001, PwC had advised that £150,000 in sponsorship was an ambitious, high risk target. The Arts Council appointed the same consultants as had reviewed the October 2003 plan to examine the revised version. The consultants concluded in September 2004 that 'there is judged to be a credible prospect that the organisation will be able to deliver a balanced budget for 2005. However, there is also a high risk that the organisation will face a material unplanned deficit (more than £200,000) and there are few options open to the WMC to take avoiding action in time'. The consultants advised that, because of the high risk of incurring losses, the WMC should develop clear policies on unanticipated deficits and contingency plans. These recommendations on contingency plans were not followed up by the Arts Council or the Assembly Government who also saw the report.

The Assembly Government did not assess and address the financial risks at the time of opening, choosing instead to wait and see what actually happened

3.22 The break-even position for the WMC in its July 2004 business plan did not take account of the impact of having to pay off its bank loan. In a separate sensitivity analysis, the WMC's business plan referred to the possibility that, in a worst-case scenario, there would be a £2 million capital shortfall, which would require a payment of £500,000 in 2005 to pay off the interest and capital over the medium term. However, in our view, £2 million was by no means the worst-case scenario. As Figure 8 shows, the WMC forecast having a loan of at least £7 million at the end of 2004, reducing to just over £2 million at the end of 2005 if the WMC met its fundraising targets (Part 2). On this basis, a shortfall of £2 million in 2005 was a best-case, rather than worst case scenario. The Assembly Government had previously recognised that it might have to examine its options in the case that the WMC did not pay off the loan before opening (paragraph 2.6), but there is no evidence on record that, at the time of opening, the funders assessed the risks associated with the loan. They did not, for example, request that the WMC update the monthly capital cash flow forecasts it produced for funders to include the operational cash flow. Combined cash flow forecasts would have demonstrated how and when the loan would be paid off and the impact of the interest payments on the business plan.

3.23 Assembly Government officials told us that they were aware that the business plan was risky, and that there was a chance that the WMC would need more subsidy. But given that WMC had not yet opened and established the actual income and costs, officials did not feel able to justify any increase in funding in advance of the WMC opening. Instead, they decided to wait and see what actually happened once the centre had opened. Officials told us that their approach reflected a more general desire to ensure that the level of public funding provided should be pitched at a level no greater than that required to ensure that the Government's objectives for the project were met whilst also retaining a clear incentive for the centre to operate in as commercial a manner as possible.

3.24 In our view, it was not the case that the Assembly Government's options were limited to providing more revenue funding or not, as the approach outlined by officials implies. It was reasonable to put pressure on the WMC to meet its targets, but this general pressure needed to be supported by a clear plan for monitoring progress against risks – as the funders had done during the construction phase. Because the funders did not assess the residual risks at the point of opening, no risk based monitoring plan could be developed in advance of the opening date.

Part 4 - There were deficiencies in monitoring post-opening that were not addressed until the Wales Millennium Centre requested additional public funding to avert financial crisis

4.1 The WMC opened to the public in November 2004. At that point, two of the funders, the Assembly Government and the Arts Council, retained an interest in the continuing work of the WMC. The Assembly Government had a direct financial interest as guarantor of bank lending to the WMC, as provider of continuing revenue grant and as the funder to whom the WMC would turn if it experienced financial difficulties. The Arts Council was not a revenue funder of the WMC but continued to fund companies resident there and retained an interest in seeing that the WMC was providing the artistic offering promised when the Arts Council awarded its capital grants. After opening, the WMC had a number of successes: it attracted more than a million people to its performances, and more than three million have visited for the free events, retail, and other facilities that the Centre offers. However, the Centre has also had some well-publicised financial problems. This part of the report examines whether the funders have effectively monitored the WMC's progress since it opened.

4.2 We found that there were some deficiencies in monitoring:

- In the case of the Assembly Government, there were severe deficiencies in the arrangements put in place. Wholly inadequate record keeping by officials hampered their ability to monitor the WMC. The absence of proper records combined with staff changes has prevented Assembly Government officials from acquiring the necessary degree of understanding of the WMC's finances and its business and therefore of the likely financial consequences for the Assembly Government.
- The Arts Council's monitoring of the WMC has been proportionate to its interests in the Centre, but the Arts Council's records were also insufficient.

There were significant deficiencies in the Assembly Government's monitoring of the operations of the Wales Millennium Centre until the Wales Millennium Centre reached a financial crisis

In the initial period after opening, the Assembly Government did not gain sufficient understanding of the WMC's business

4.3 As the revenue funder, the Assembly Government had the primary responsibility for monitoring the WMC's business to ensure that its ongoing investment was safeguarded. Monitoring the WMC was a novel challenge for the Assembly Government, as it is the only arts project that it funds directly, rather than through the Arts Council. Given its strategy of placing pressure on the WMC to operate as efficiently as possible (paragraph 3.23), it was incumbent on the Assembly Government to monitor the WMC's performance closely, once it had opened. In particular, the Assembly Government needed to monitor the underlying financial health of the WMC, because of the risks attached to carrying the burden of a large loan into the operational phase (paragraph 2.10).

4.4 The Assembly Government has monitored progress since opening, primarily through attendance as an observer, along with the Chief Executive of the Arts Council, at WMC Board meetings, through monthly meetings between the WMC and Assembly Government officials and twice-yearly meetings between the Culture Minister and the Chair of the WMC. The Assembly Government's original revenue funding agreement with the WMC included an operational protocol which required that detailed information on performance be provided by the WMC. The agreement was not signed until late 2006, two years after the WMC opened and the Assembly Government began providing the revenue subsidy. In the interim, the Assembly Government's grant agreement covering the construction phase remained operational but this agreement did not cover issues relating to the running of the WMC.

4.5 Officials wrote to the WMC in July 2005, eight months after opening, setting out a proposed interim monitoring protocol. This protocol set out the Assembly Government's requirements for information on progress against business plan targets and audience levels. There are no further records on Assembly Government files relating to this proposed monitoring protocol. The Assembly Government's note of a meeting later in July 2005 records that the WMC said that it did not intend to provide detailed information on ticket sales because of concerns about commercially confidential information being released under the Freedom of Information Act (FOIA), although the WMC disputes that it refused to provide the Assembly Government with such information. The Assembly Government subsequently decided that it would not keep records of the WMC's performance, nor any papers from the WMC Board meetings. As a consequence, there is very little information about the WMC's performance over the period July 2005 to October 2006 on the Assembly Government's records.

4.6 The approach adopted by the Assembly Government was a fundamental misinterpretation of the FOIA. The main objective of the FOIA is to facilitate more open and transparent governance, not to deter officials from holding the records that they need to carry out their jobs. The FOIA contains exemptions that public bodies can apply to prevent the release of commercially sensitive information, if appropriate. During the course of our examination, the Assembly Government reversed its decision and now holds Board papers and other records. However, the lack of records and information has impaired the capacity of Assembly Government officials to monitor the WMC. The problem of lack of records has been compounded by staff changes within the Assembly Government sponsor division, which have meant that staff taking over responsibility for monitoring have had very little information to rely on to develop their understanding of the WMC's business and finances.

4.7 Officials told us that they were able to monitor performance using the information in WMC Board papers, even though these were not routinely retained on Assembly Government files. However, in our view, relying on the Board papers was not sufficient:

- The Board papers provided by the WMC in advance of Board meetings did not contain comprehensive data on the WMC's financial performance – in the level of detail that officials needed. For example, from July 2005 onwards, detailed information on commercial ticket sales was no longer included in WMC Board reports.

- Officials and the WMC told us that management accounts, containing more detailed financial information, were tabled at Board meetings (rather than being provided in advance). But because they were not subsequently retained on Assembly Government files, officials had very limited opportunity to analyse the financial data on these management accounts in depth.

4.8 Officials told us that they had access to detailed performance and financial information held by the WMC on request. Assembly Government records show that, in preparing advice for a meeting of the Culture Minister and Chair of the WMC in mid-2006, officials asked the WMC for detailed information on ticket sales, but the WMC was not prepared to provide the information requested because of concerns about commercial confidentiality and freedom of information. The WMC disputes that such a request was turned down. There are no records of any other requests of this sort by the Assembly Government, nor of it receiving any more detailed information from the WMC, in the period before October 2006.

4.9 The Assembly Government also held regular monitoring meetings with the WMC. Officials told us that reports containing detailed information were tabled at monthly meetings between the WMC and Assembly Government officials. However, there are only Assembly Government records of two such meetings before October 2006, when the WMC requested additional funding. Neither of these records contains detailed information about the WMC's finances or performance. The notes of the twice-yearly meetings between the Culture Minister and the Chair of the WMC show that these meetings focused generally on the WMC's budget forecasts and other high level issues, although the WMC and Assembly Government officials told us that the financial challenges facing the WMC were discussed. Assembly Government officials told us that the WMC presented financial and performance information at these meetings, but there is no detailed financial or performance data, other than the overall annual deficit forecast, recorded in the minutes. Any additional information made available by the WMC at these meetings was not kept on Assembly Government files.

4.10 Assembly Government officials believe that they had sufficient information to monitor the overall position at the WMC. They told us that their high-level understanding of the WMC's finances and performances was adequate for their approach of putting general pressure on the WMC, particularly through the Culture Minister's meetings with the WMC, to operate as efficiently as possible. However, in our view, the Assembly Government did not hold sufficient information on which to base a rigorous programme of monitoring. This lack of information would have prevented officials from challenging the WMC effectively on, for example, how it intended to pay back the loan. It would also have impaired officials' ability to provide advice, as was the case in May 2006, when officials were unable to fully advise the then Culture Minister on the WMC's commercial performance because they did not have the necessary information on ticket sales.

In agreeing to extend its loan guarantee in 2005 and again in 2006, the Assembly Government did not probe sufficiently the capability of the WMC to pay off the loan

4.11 The Assembly Government continued to renew its guarantee of the WMC's loan but, until October 2006, did not fully review the impact of the loan on the WMC's business, and the likelihood of it being paid off. The Assembly Government renewed the loan in

Source: Wales Millennium Centre

June 2005, shortly after the WMC reported that it would incur a £1.7 million deficit for the year, which would be funded by principal donor money and other funding previously allocated to paying off the capital shortfall (Figure 9). At the time, officials did not request a detailed cash flow forecast from the WMC showing how and when the loan would be paid off. In November 2005, the WMC agreed that it would produce a five-year plan for repaying the loan.

4.12 The Assembly Government renewed its loan guarantee again in May 2006, by which time the WMC had received its final capital grants from the public funders; these helped reduce the loan to £11 million. The WMC planned to pay off the remaining loan over the period 2008 to 2017. We have seen no evidence that officials robustly assessed the likelihood of this repayment plan being implemented. Nor did officials examine in detail why the WMC had been unable to pay off the bulk of the loan using the capital funding it expected to receive in 2005 (paragraph 2.10 and Figure 9). In our view, had officials carried out a detailed assessment, they would have recognised that it was highly unlikely that the WMC could generate a surplus to start loan repayments by 2008 because:

- the WMC's business plans showed that it was incurring large annual deficits; and
- from 2011 onwards, the WMC's financial position would have been more challenging because it would no longer be in receipt of its annual donation of around £1 million from its principal donor.

Also, the interest payments over this long period would have had a material impact on the WMC's viability. The WMC spent a total of £2 million servicing the interest charges on the loan, until it was paid off by the Assembly Government in November 2007.

Faced with a financial crisis at the Wales Millennium Centre, the Assembly Government developed an improved understanding of the Wales Millennium Centre's business and actively sought to address the Wales Millennium Centre's finances

4.13 In October 2006, the Chair of the WMC informed the Culture Minister that the WMC was facing severe financial difficulties. A supporting paper argued that the WMC had been successful in generating income in line with its targets for 2006, but that costs had proved to be significantly higher than anticipated. The WMC paper requested that the Assembly Government urgently consider:

- converting the loan from HSBC, which was then £11 million, to an interest free loan from the Assembly Government, which would save £500,000 a year, with an initial payment holiday to be negotiated; and

- increasing revenue funding to £2.7 million (excluding the fund for repair), linked to inflation from 2007; or

- if the Assembly Government was unable to agree the revenue subsidy increase for 2007, it could provide an interest-free loan of £13 million and address the subsidy need in 2008.

4.14 In response, the Assembly Government and Arts Council engaged the consultants who had carried out earlier assessments of the WMC's business plan (paragraphs 3.18 and 3.21) to review the current WMC operations and to advise on the revenue subsidy needed. In order to manage the WMC's immediate finance needs, the Assembly Government agreed to increase its guarantee on the existing HSBC loan to £13.5 million to enable the WMC to continue operating in the short-term.

4.15 The consultants reported in May 2007 that the WMC was generally well run, with audience levels at around the maximum that could be expected. Because the WMC's figures showed that it had been incurring annual operating losses, and the forecast showed little prospect of it generating any operating surplus, the consultants' review concluded that there was no real prospect of the WMC paying back the bank loan. The consultants therefore recommended that the Assembly Government should pay it off as soon as possible in order to avoid further interest charges. The consultants also calculated that the WMC might need a subsidy of between £3 million and £3.75 million, and possibly more, excluding interest payments on the loan. However, the consultants' report did not make a clear recommendation that Assembly Government should agree this level of subsidy, as there were heavy caveats about the robustness of the underlying figures, and the report said that no firm recommendation could be made until the WMC and the Assembly Government engaged in detailed negotiations.

4.16 Over the summer of 2007, the Assembly Government carried out further examinations of revised WMC forecasts, with support from Finance Wales[12]. As part of this review Assembly Government officials spoke with WMC staff to test their future plans and how they related to past performance. The review concluded that:

- the financial projections were reasonably well founded, although in some areas income might have been understated;

- there was no realistic prospect of the WMC paying off the loan;

- the Assembly Government could not do nothing because without extra funding the WMC could become insolvent, in which case the Assembly Government would have to pay off the loan; and

- providing Assembly Government funds to pay the loan off immediately offered better value for money than providing extra revenue to pay off the loan over time.

4.17 Based on the findings of the review and those of the consultants, officials advised Ministers in October 2007 that they should pay off the loan, and that the revenue agreement should be increased. The advice identified the outstanding risks and recommended that strict conditions should be attached to the funding:

- the WMC should provide detailed performance information against a range of indicators of efficiency and effectiveness to support closer monitoring of performance; and

12 Finance Wales is an Assembly Government-owned company that provides business support and financial services to companies in Wales.

- there should be an independent review of corporate governance at the WMC, and of the skills of the WMC Board.

4.18 In November 2007, the Culture Minister announced that the Assembly Government would pay off the HSBC loan, and that WMC's annual revenue subsidy would rise to £3.7 million from 2008-09. The Culture Minister announced that there would be conditions attached to the funding, including targets to improve efficiency. The Assembly Government also told the WMC that it could bid separately for additional capital funding for maintenance. In December 2007, the Assembly Government paid off the loan, which then stood at £13.5 million, and provided WMC with an advance of £1 million from its 2008-09 revenue funding. In July 2008, the Assembly Government and WMC signed a revised revenue funding agreement, governing the release of Assembly Government funds.

4.19 Assembly Government officials told us that, in examining the subsidy requirements of the WMC, they took comfort from the fact that they had two years' worth of actual performance information on which to base their assessment. This included the detail in the consultants' report showing that the WMC had been successful from a cultural and audience development perspective. However, neither the consultants' review, nor the subsequent review by the Assembly Government, included any reference to the audited outturn figures for 2006, which had been publicly available since the summer of 2007. Figures which have been subject to external audit provide firmer evidence on recent financial performance than the budget forecasts used by the consultants, and the management accounts produced in 2007 that were examined as part of the review by the Assembly Government. During the course of our examination we identified some differences between the budget figures for 2006 provided to the consultants and the audited out-turn, particularly in terms of theatre income, donations and staff costs. Because they did not have a detailed understanding of the WMC's finances, Assembly Government officials were not able to reconcile these differences themselves without asking the WMC.

The Arts Council's monitoring of progress has been broadly proportionate to its role

4.20 The Arts Council, along with the Assembly Government, attends the WMC Board meetings as an observer. Unlike the Assembly Government, the Arts Council is not a revenue funder of the WMC; it therefore has a different focus in monitoring, and has less leverage and influence over the WMC. However, the Arts Council has a significant vested interest in the future viability of the WMC, in terms of the expected arts benefits from the £10 million it provided towards construction, and because six of the seven resident organisations are funded by the Arts Council (Appendix 1).

4.21 The Arts Council followed the Assembly Government's lead on the issue of record keeping and has not kept detailed information and Board papers because of concerns about a possible request under the FOIA. Arts Council officials told us that they are content that they have had access to sufficiently robust information through the WMC Board reports, as well as through meetings with the WMC officials, although these are not minuted. Nevertheless, Arts Council officials recognised that they would have required more detailed information if the WMC had been its revenue client.

Source: Wales Millennium Centre/Kiran Ridley

4.22 The Arts Council has played an important role in helping to address some of the difficulties in the relationships between the resident organisations and the WMC. Discussions between the Arts Council, WMC, and WNO on the 'dark nights' issue (box after Figure 11) took place between January and March 2008. The WMC is now working on assessing the financial impact of the 'dark nights'; once agreed, the financial implications will be used to inform future funding discussions. And following meetings facilitated by the Arts Council, the WMC and its resident organisations agreed a new creative vision and programme of collaborative activity in April 2008.

Appendix 1 - About the Wales Millennium Centre and the organisations resident there

The WMC opened in 2004 and classifies itself as one of the World's iconic arts and cultural destinations. The WMC's vision is to be 'unmistakably Welsh and internationally outstanding': an internationally significant cultural landmark and centre for the performing arts, renowned for inspiration, excellence and leadership. The WMC has two stages – the Donald Gordon theatre and the smaller Weston Studio. The WMC puts on a range of performances: West End musicals, opera, ballet and contemporary dance, hip hop and stand-up comedy in its two theatres. In the public areas it also puts on art exhibitions, workshops, training days, free daily foyer performances, guided tours, and there are also bars, restaurants and retail outlets.

The WMC raises the majority of its income from commercial sales and sponsorship, although it receives annual revenue support from the Assembly Government, which has recently risen from £750,000 to £3.7 million.

The WMC building hosts seven resident organisations, all of which pay a peppercorn rent to the WMC. Of these seven resident organisations, six receive revenue funding from the Arts Council[13]:

- Welsh National Opera – has rehearsal, performance and administrative space at the WMC. Welsh National Opera performances at the WMC have been highly popular, with many selling out.
- Diversions – the National Dance Company of Wales tours throughout the UK and abroad performing the work of established international choreographers. Diversions puts on performances at its Dance House in the WMC.
- Academi – the National Literature Promotion Agency and Society for Writers with responsibility for serving writers and readers across Wales. At the WMC, the Academi stages a variety of events including performances, workshops, celebrations of great authors, conferences, literary competitions, slams, stomps, discussions and more.
- Hijinx Theatre – aims to create high quality theatre which is accessible, entertaining and challenging for small communities throughout Wales and England. At the WMC, Hijinx has office space, and performs in the Weston Studio.
- Tŷ Cerdd – is a partnership between four musical organisations and provides a one stop 'Music House' based at the WMC. Facilities include a recording studio, listening booths and information points, and an extensive library of research and performance scores.
- Touch Trust – provides creative, touch-based art of movement and dance programmes for individuals affected by autism, behaviour that challenges and profound and multiple disabilities. Touch Trust has a purpose-built multi-sensory suite in the WMC. As well as daily sessions, Touch Trust stages Days of Dance performances and Weekend and Holiday Workshops in collaboration with Welsh community dance and arts organisations and independent artists.

The WMC is also home to the Urdd Gobiath Cymru, which was established to give children and young people the opportunity to learn and socialise through the medium of Welsh. At the WMC, the Urdd has residential space for 150 young people. Each year, 10,000 children come and stay for short

13 The Touch Trust, although funded by the Arts Council, does not receive any of the additional £800,000 paid to some resident organisations to meet the extra costs of occupying the WMC (paragraph 3.11).

and week-long breaks. Every four years, starting in 2005, the Urdd will stage the Urdd National Eisteddfod in the WMC. This is the largest competitive youth festival in Europe. The Urdd receives revenue funding from the Welsh Language Board.

Appendix 2 - Methods

This report examined whether the funders have effectively addressed the risks involved in funding:

- the construction of the WMC; and
- the operation of the WMC.

We carried out our examination using the following methods:

- file review – we examined the records held by the Assembly Government, including the records of the former WDA, the Arts Council and the WMC. In particular, we focused on:
  - a funders' appraisals of the construction project;
  - b funders' appraisals of the WMC's business plans;
  - c officials' advice and recommendations to Ministers;
  - d project monitoring reports;
  - e minutes of monitoring meetings; and
  - f WMC board papers.
- semi-structured interviews – with Assembly Government officials, including those from the former WDA, and Arts Council officials, Big Lottery Fund officials, WMC staff, and staff from the Lowri Centre;
- review of best practice – we examined best practice in relation to construction projects from the OGC (Achieving Excellence in Construction) and the National Audit Office; and
- visit to comparators – we visited the Lowri Centre multi-arts venue in Salford, Manchester to examine some of the differences and similarities with the WMC.