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Archwilydd Cyffredinol Cymru
Auditor General for Wales

Establishment and oversight of the Wales Life Sciences Investment Fund



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU



I have prepared and published this report in accordance with the Government of Wales Acts 1998 and 2006.

The Wales Audit Office team who delivered the work for the Auditor General comprised Mike Usher and Mark Jones, supported by Grant Thornton LLP and the Internal Audit Service of the Welsh Government.

**Huw Vaughan Thomas
Auditor General for Wales
Wales Audit Office
24 Cathedral Road
Cardiff
CF11 9LJ**

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Summary

Establishment and oversight of the Wales Life Sciences Investment Fund

- 1 The 'life sciences' (primarily biology, medical bio-technology, genetics and related disciplines) are a significant and growing driver of economic growth in modern industrialised nations across the globe, and many governments are either investing or supporting investment in this important business sector. In Wales, the Wales Life Sciences Investment Fund (the Fund) was announced in March 2012 by the Minister for Economy, Science and Transport.
- 2 The Fund is a dedicated equity fund that is held on behalf of the Welsh Government by Finance Wales Plc (Finance Wales). The Fund has a target investment value of £100 million for investment in life-sciences businesses located, or to be located, in Wales. To date, the Welsh Government has committed £50 million¹, with the initial expectation² that a further £50 million in match funding will be attracted from the private sector in due course by the contracted Fund Manager, Arthurian Life Sciences Ltd (the Fund Manager). Arthurian is majority but not wholly owned by Professor Sir Christopher Evans, who is also a Director of the company (being a Limited Partner for the Fund).
- 3 It is clear from both the Invitation To Tender and the Fund documentation that the Fund is intended to be run on a commercial basis with the primary aim of generating capital growth and returns for the Fund's investors, subject to compliance with State Aid Rules. The Fund Manager stressed to us that by working on this intended basis, the Fund's investments are not akin to the provision of public monies through more typical means such as grant funding.
- 4 In March 2015 the Fund Manager announced its intention to seek to raise £150 million or more from leading worldwide institutional investors. The Fund Manager's intention is that this will be available for investment in the life sciences sector in Wales, to back the Fund's current investments and for co-investment alongside the Fund in new investments. The Fund Manager's ambition is to create an investment portfolio of 25 to 30 companies, alongside support for university research and commercial spin-out activities, together with any further Welsh Government funding commitments and the scope to attract additional Limited Partners into the Fund itself.
- 5 However, it is important to note that this audit report does not consider whether the investment performance of the Fund itself is delivering value for money. This is because such an assessment can only sensibly be undertaken once the Fund has established a longer track record of overall performance against its targets for investments and the securing of private-sector match-funding. In August 2015 the Fund Manager proposed to Finance Wales that it should perform a formal value-for-money review of the Fund's investments. Finance Wales judged that

¹ £25 million was committed in March 2012; and a further £25 million was committed in February 2013.

² The contracts in place (see paragraphs 1.4 and 1.31) require the Fund Manager to use its 'best endeavours' to raise an additional £50 million of private-sector funding by 31 December 2015.

it was too early for such a review to be meaningful. Finance Wales is, however, currently procuring a three-year review (to February 2016) of the Fund Manager's performance.

- 6 In September 2013 the Auditor General received an enquiry via the Chair of the Public Accounts Committee from a member of the public relating to the Fund's August 2013 investment in ReNeuron Plc. In response, the Auditor General decided to conduct an audit review of the establishment, governance, oversight and early operation of the Fund. On behalf of the Auditor General, Wales Audit Office staff have examined whether the Welsh Government and Finance Wales established the Fund and oversaw its initial operations effectively.
- 7 Our review was also able to draw on a contemporaneous review of aspects of the Fund, undertaken by the Welsh Government's Internal Audit Department at the request of the Principal Accounting Officer in response to media articles concerning aspects of the Fund's operations and its oversight by the Welsh Government. The findings set out within this report therefore draw on the evidence provided by the Internal Audit review to the extent that:
 - a Internal Audit initially examined the Welsh Government's actions;
 - b both Internal Audit and staff of the Wales Audit Office jointly examined the actions of Finance Wales; and
 - c Wales Audit Office staff examined the actions of the Fund Manager, Arthurian.
- 8 Internal Audit issued its final report in June 2014. The Welsh Government accepted all of its 11 recommendations, which are set out in [Appendix 2](#). In 2015 Internal Audit reviewed the Welsh Government's progress against the recommendations and reported its findings on 27 March 2015. The follow-up review provided 'reasonable assurance' over the actions taken by Welsh Government management, as one recommendation was outstanding and three recommendations were work in progress. The review also raised one further recommendation with regard to the communication channels between the Welsh Government, Finance Wales and the Fund Manager. Further to the above audit work, the Auditor General also commissioned independent expertise from Grant Thornton UK LLP (Grant Thornton).

Overall conclusions

- 9 The concept of the Fund, which aims to foster investment and stimulate economic growth within the life sciences sector in Wales, is innovative and has many merits. The audit recommendations in this report address issues that we have identified in respect of the Welsh Government's management of its relationship with its own arms-length body, Finance Wales, and also in dealing with a private-sector entity contracted to act as an agent responsible for the management of public funds. Our recommendations, many of which are of wider application to other departments of the Welsh Government, are intended to support and improve well-managed risk-taking and good governance, rather than to stifle innovation. It remains vitally important that the Welsh Government continues to explore new ways of supporting its policy priorities that are sustainable and harness the skills, experience and finance of the private sector.
- 10 We concluded that several aspects of the establishment, governance, oversight and early operation of the Fund were flawed and/or poorly documented. Specifically, we consider that:
- a a conflict of interest was appropriately declared but this should have been handled more robustly by the Welsh Government;
 - b the decision to procure a fund manager was poorly documented, with no contemporaneous records to demonstrate that contracting a fund manager would provide better value for money than the recruitment of specialist staff by Finance Wales itself;
 - c there were some significant shortcomings in Finance Wales' procurement of the Fund Manager;
 - d neither the Welsh Government nor Finance Wales are able to provide adequate justification for the totality of their payments to the successful tenderer under the interim arrangements;
 - e the oversight arrangements put in place by Finance Wales were insufficiently robust, and as a result one aspect of the investment in ReNeuron Plc was not handled in accordance with the Fund Management contracts;
 - f alongside the Fund's investment in ReNeuron Plc, the Welsh Government's award of in-principle support to ReNeuron did not comply with its usual business processes, and it is not possible to confirm whether it handled appropriately a clear conflict of interest that had been declared to it;
 - g our review of the Fund's third investment found that conflicts of interest had been properly managed by all concerned, and to date Finance Wales has not identified any concerns regarding the handling of conflicts in the Fund's subsequent investments;

- h neither Finance Wales, nor indeed the Welsh Government, are currently able to exercise any contractual control over the arrangement fees charged by the Fund Manager, as the scope for levying such fees was overlooked during the procurement process;
 - i by opting to relinquish its contractual right to remove the Fund Manager without cause, Finance Wales has reduced its ability to exercise control over the fund management contract, and undermined its own legal power to intervene on arrangement fees; and
 - j the Welsh Government has yet to determine the extent to which it expects private-sector entities that are contracted to manage and deliver public services on its behalf to comply with the Nolan Principles.
- 11 We have seen no evidence that the Fund Manager is acting in any way improperly or incorrectly in applying a commercial approach to the management of the Fund. In that context, we found that:
- a the levying of 'arrangement' or 'negotiation' fees on investee companies by fund managers is an industry-standard practice; and
 - b in the absence of any prescribed constraints within the Fund management contract, the level of any such fees, and indeed any other type of corporate finance fees that may arise, is ultimately a matter for commercial negotiation between the Fund Manager and the investee companies.
- 12 In response to Internal Audit's recommendations in [Appendix 2](#), the Welsh Government agreed to prepare a 'Lessons Learnt Report' by 31 July 2014 and implement it by October 2014. A copy of the Lessons Learned Report, including the actions that management within the Department for the Economy, Science and Transport are taking in response to it, is in [Appendix 3](#). Relevant extracts from a report produced for Finance Wales by its own internal auditors are in [Appendix 4](#). The audit method adopted by the study team is in [Appendix 5](#).

Recommendations

- 13 We have raised nine recommendations, further to those raised by Internal Audit. All of our recommendations are addressed to the Welsh Government alone, as it holds the Accounting Officer responsibility for Finance Wales.

Recommendation	
R1	The Welsh Government should provide clear and comprehensive guidance to all members of its departmental working groups, including all other sector panels, on the governance requirements placed on members and other attendees with regard to their disclosure of actual, potential, or perceived conflicts of interest. This should also include clear guidance to their secretariats.
R2	The Welsh Government should ensure that this guidance provides good examples of typical mitigating actions for common conflicts and highlights that, when necessary, secretariat officials should seek the formal advice of departmental compliance officers and, if then deemed necessary, the expert advice of the Welsh Government's central Corporate Governance Unit.
R3	The Welsh Government should review the rigour, clarity and communication of its guidance to staff on the timely engagement of legal services.
R4	In the event of material changes to a business case (including the content of Ministerial submissions), Welsh Government officials should seek further legal advice on the revised proposals and ensure that an updated business case is prepared that draws on that advice.
R5	The Welsh Government should set out clearly to Finance Wales its expectations with regard to Finance Wales's role in managing its contract with the Fund Manager.
R6	In respect of the Fund's fourth investment, in Simbec-Orion Group Ltd, for which our audit has established that conflicts did exist at the time of the investment, the Welsh Government should seek to verify whether: <ul style="list-style-type: none"> • the Fund Manager reported its conflicts of interest to Finance Wales, as required; • the relevant Directors of the Fund Manager stood down fully from the investment discussions and decision, as required; • the Fund Manager received any arrangement fees; and • if the Fund Manager did receive fees, their value and justification.
R7	In respect of the Fund's seven subsequent investments (see paragraph 1.82), which our audit has not reviewed, the Welsh Government should seek to establish whether: <ul style="list-style-type: none"> • the Fund Manager had any conflicts of interest and, if it did, whether they were disclosed to Finance Wales as required; • the Fund Manager received any arrangement fees; and • if the Fund Manager did receive fees, their value.
R8	The Welsh Government should ensure that Finance Wales formally engages with the Fund Manager to seek to agree: (i) a set basis for the calculation of arrangement fees; and (ii) a cap on such fees.

Recommendation

R9 The Welsh Government should:

- Determine the extent to which it expects private-sector entities that are contracted as agents of government to manage and deliver public services to conduct that work in accordance with the Nolan Principles.
- Provide clear guidance to its officials, and to its arms-length and sponsored bodies, as to its expectations in this regard. That guidance should include a requirement that appropriate specific conditions are included in future contracts for the provision of public services in Wales.

Detailed Report



A conflict of interest was appropriately declared but this should have been handled more robustly by the Welsh Government

- 1.1 The Welsh Government operates six Sector Panels, whose membership is drawn from the private sector and other sources of expertise outside of the Welsh Government. One of these six panels is the 'Life Sciences Sector Panel'. Panel members are not employees of the Welsh Government and as such have no management responsibilities. All of the panels work to the same terms of reference, with their primary responsibility being to: 'work to Ministerial policy direction to establish suitable and effective mechanisms for ensuring appropriate strategy; and to advise the Welsh Government as it establishes short, medium and long term measures for these sectors in Wales'.
- 1.2 In November 2011, each of the six Panels submitted to the Minister for Business, Enterprise, Technology and Science³ a comprehensive paper setting out their views and recommendations on Sector Strategic Priorities. Within their own paper, the Life Sciences Sector Panel⁴ (then chaired by Sir Christopher Evans) included the recommendation that the Minister should create 'a Life Sciences Fund which is commercially managed by proven investment professionals'. The minutes of the Life Sciences Sector Panel show that the Panel remained engaged in the development of its life-science proposals, and Welsh Government officials made a formal submission to the Minister in March 2012 (see [paragraph 1.11](#)).
- 1.3 On 14 May 2012, Sir Christopher Evans wrote to the Chief Executive of Finance Wales declaring his personal interest in managing the proposed life sciences investment fund. The next day, on 15 May, he also declared his interest to Welsh Government officials. After these declarations, he then met with Welsh Government and Finance Wales officials to outline his proposal to provide fund management activities. We consider that these declarations were appropriate as it was important to notify both Finance Wales and the Welsh Government of the interest in a timely manner. On 24 May 2012, the Chief Executive of Finance Wales wrote to inform him that Finance Wales would be procuring a fund manager through an open tender process, in order to comply with State Aid and procurement rules. The procurement of a fund manager by Finance Wales subsequently commenced in July 2012.
- 1.4 Following Sir Christopher Evans's May 2012 declaration of his personal interest in managing the fund, he remained as Chair of the Welsh Government's Life Sciences Sector Panel (the Sector Panel) throughout the procurement of a fund manager, for which his company Arthurian Life Sciences Ltd (Arthurian) had tendered. The contract was awarded to Arthurian on 8 October 2012, although the Fund Manager contracts⁵ were not finalised and signed until 28 February 2013 (see [paragraph 1.31](#)). He resigned as Chair (and also as a member) of the Sector Panel on 19 February 2013.

³ In March 2013, the First Minister announced some changes to Ministerial portfolios and Departmental responsibilities, which resulted in the Minister for Business, Enterprise, Technology and Science becoming the Minister for Economy, Science and Transport.

⁴ Since 2011 the Panel has comprised between four and seven Members. In October 2011, it had six Members.

⁵ The Limited Partnership Agreement and the Management Agreement.

- 1.5 Welsh Government officials told us that they saw no direct link between the procurement exercise and the continued role of the Sector Panel Chair. They had considered that the Sector Panel Chair would not have been privy to advantageous documents or information during the procurement process, partly because the Welsh Government's key official, the (then) Life Sciences Sector Head, had withdrawn from the procurement process itself.
- 1.6 Welsh Government officials also told us that the Sector Panel had no influence over the procurement and appointment of the Fund Manager, as the only direct link between the Welsh Government and the appointment of the Fund Manager was that one Welsh Government official (who had no contact with the Sector Panel) sat on the Finance Wales Procurement Panel of four assessors⁶. We were able to confirm that the minutes of Sector Panel meetings made only passing reference to progress with the procurement process, and did not indicate that the Sector Panel had itself been involved in any decisions.
- 1.7 We consider that Welsh Government officials should have taken stronger action to mitigate any remaining perceptions of a conflict between the then Sector Panel Chair and the assessment of his company's tender submission to take on the fund manager role. This increased the risk that one of the other companies expressing an interest in the fund manager role could have raised concerns about the fairness of the tender submission and evaluation process. We therefore consider that it would have been appropriate for the Welsh Government to have asked the Sector Panel Chair to stand down temporarily from attending and participating in the work of the Panel until the procurement process had been completed and the outcome known, with an interim Chair being put in place.
- 1.8 The Welsh Government makes extensive use of sector panels and similar groups. Given the importance of their work we consider that the Welsh Government needs to obtain assurance that all such panels and similar groups fully understand the expectations placed upon them in terms of their conduct. We have set out two recommendations in respect of this area of assurance ([Recommendation 1](#) and [Recommendation 2](#) on [page 10](#)).
- 1.9 Internal Audit also recommended (see [Appendix 2](#)) that:
- a Sector Panel Members be reminded of the need to declare all conflicts of interest as they arise and that guidance is provided to them on what constitutes a conflict; and
 - b Panel Members confirm the absence or existence of declarations of interest at each meeting, with mitigating actions agreed and minuted.
- 1.10 As noted in [Appendix 2](#), Welsh Government officials have accepted these two Internal Audit recommendations, with immediate implementation.

⁶ The Procurement Panel comprised: Finance Wales's (then) Strategic Investment Director; Finance Wales's (then) Senior Independent Director; the Welsh Government's Department for Economy, Science and Transport's Deputy Director Delivery; and, as an independent member of the Panel, the Chief Investment and Financial Officer of a large charitable organisation.

The decision to procure a fund manager was poorly documented, with no contemporaneous records to demonstrate that contracting a fund manager would provide better value for money than the recruitment of specialist staff by Finance Wales itself

- 1.11 The Welsh Government's Strategic Outline Business Case set out three potential options for managing the Fund: (i) in-house by the Welsh Government; (ii) outsourced by the Welsh Government; or (iii) managed by Finance Wales. The three options were carefully evaluated within the business case and the preferred option was for Finance Wales to manage the Fund. The business case recognised that Finance Wales might not possess the necessary expertise in life sciences and would therefore need to recruit or appoint the fund management team. Similarly, the final Ministerial submission paper, dated 8 March 2012, stated that Finance Wales would establish and manage the Fund on behalf of the Welsh Government and referred to the need for Finance Wales to recruit an Investment Panel and Fund Management Team of the highest quality.
- 1.12 Internal Audit examined the Welsh Government's decision that Finance Wales should procure a fund manager via a competitive tender exercise, but found no contemporaneous documentary evidence to demonstrate that contracting with a fund manager would provide better value for money than the recruitment of staff possessing specialist fund management skills by Finance Wales itself.
- 1.13 In accordance with the Welsh Government's mandated procedures, the Ministerial submission set out the legal advice that had been sought by officials. However, the legal advice provided within submission was predicated on the statement that: 'Legal Services have not been involved in the development of these proposals and have not had the opportunity to consider them in detail.'
- 1.14 The legal advice, which was provided on procurement and state aid matters, recorded that it was being provided on the 'understanding' that '...Finance Wales will establish and manage the Fund on behalf of the Welsh Government and would be paid a fee for doing so. On the face of it, this would be a contract between the Welsh Government and Finance Wales.'
- 1.15 We note that the 'understanding' of Legal Services, on which they based their advice within the Ministerial submission, did not reflect the eventual decision to procure a fund manager, rather than for Finance Wales to directly manage the fund itself. There is a lack of documentation that sets out the subsequent proposal, and decision, by the Welsh Government and Finance Wales to procure a fund manager. Welsh Government officials acknowledge that the documentation, including the content of the final Ministerial submission, did not keep pace with a fast-moving set of business decisions.

- 1.16 However, we also note that in April 2014 the Minister for Economy, Science and Transport confirmed in a letter to the Director General of her department that: 'I was aware throughout the process that Finance Wales were unlikely to have the skills necessary to directly manage the Life Science Fund.'
- 1.17 We consider that the lack of full engagement of the Welsh Government's own Legal Services Department in the preparation of the final Ministerial submission appears hard to justify, given that the proposed project involved the investment of £50 million of public funds in an innovative and complex financial services arrangement.
- 1.18 In June 2015, the Welsh Government's Director of Legal Services emailed the Director General to clarify the extent of his officials' involvement during the three months to May 2012 with regard to the proposals. Although not documented at the time, the Director of Legal Services stated in his email that his officials had been content with the proposals on the basis that:
- a 'the fund will contain only public money;
 - b it will be managed by a Fund Manager openly procured by Finance Wales;
 - c investment decisions will be made by an investment panel/committee;
 - d at project level, investments will be made in accordance with the market, economy and investment principles (with the MEIP⁷ approach being written into contracts between Finance Wales and the Fund Manager and investment committee);
 - e there will be written confirmation between the Welsh Government and Finance Wales of the arrangement to be implemented'.
- 1.19 We note however that Legal Services' understanding that the Fund would contain only public money runs counter to the eventual operating basis of the Fund and the contractual requirement on the Fund Manager to attract match funding from the private sector on a 'best endeavours' basis (see [paragraph 2](#)).

There were some significant shortcomings in Finance Wales's procurement of the Fund Manager

- 1.20 Internal Audit examined the procurement of the Fund Manager (Finance Wales being the contracting authority). The Invitation To Tender (ITT) was advertised by Finance Wales under European procurement procedures in the Official Journal of the European Union. In addition, Finance Wales identified 16 potential bidders and brought the ITT directly to their attention. Finance Wales received four expressions of interest, from which only two tenders were received. Finance Wales established a Procurement Panel (see [paragraph 1.6](#) and [footnote 6](#)) to evaluate the tenders. The Internal Audit Review highlighted a number of control weaknesses within the procurement process that considered the two tenders.

⁷ The essence of the MEIP is that when a public authority invests in an enterprise on terms and conditions that would be acceptable to a private investor operating under normal market economy conditions, the investment would not be state aid.

- 1.21 Internal Audit found that the successful tenderer was unable to comply with all the mandated requirements of the ITT because it was a newly-formed company. This had arisen because Finance Wales had not undertaken adequate pre-evaluation checks on the tenders received, to ensure that each of them complied with the key requirements mandated by the ITT. While the unsuccessful tenderer had met all of the mandated requirements, the successful tenderer could not meet two of the mandated requirements, which were:
- a the submission of three years' audited accounts; and
 - b the demonstration of a minimum of £10 million of 'funds under management' for each of the previous three years.
- 1.22 Neither of these requirements could be met by the successful tenderer because it had only been incorporated some two months prior to the procurement process specifically for the purpose of bidding, and so had no track record as an entity. Welsh Government officials told us that, despite the basis of the ITT requirement that Finance Wales had put in place, in their experience it is not unusual for a company to be set up for fund management with the individuals of the company, rather than the entity, holding the fund-management experience.
- 1.23 Further to these comments, Finance Wales's officials told us that the shortcomings in the procurement of a fund manager had arisen through not fully appreciating the procurement needs at the outset, and framing the ITT accordingly. We note that the ITT had been prepared by Finance Wales with input from Welsh Government officials, was prepared in good time and was also subject to internal due diligence checks. We are therefore surprised that these defects existed in the final ITT.
- 1.24 Internal Audit also found that the two tenders had not been evaluated on a like-for-like basis when comparing their management fee costings. While the unsuccessful tenderer had used the assumption of a £25 million fund that was prescribed in the ITT, the successful tenderer had used a higher assumption of a £50 million fund. In evaluating the two tenders the Panel had failed to adjust for the successful tenderer's different assumption to ensure that a like-for-like comparison could be made⁸.
- 1.25 Both of the Internal Audit reviews (undertaken by the Welsh Government and Finance Wales) separately concluded that these shortcomings were not arithmetically material in the Procurement Panel's final decision, as the overall result and outcome would have been unchanged. They were not arithmetically material because each tender's proposed fund management cost structure accounted for a maximum of only 40 points (some 13 per cent) of an overall maximum tender evaluation score of 310 points. We compared this with three other fund management tender processes that had been undertaken by Finance Wales, and found that the cost percentage components for each were 10 per cent, 30 per cent and 50 per cent respectively. Finance Wales's decision to allocate only 13 per cent of the total score to the cost element of this fund management tender evaluation therefore placed it at the lower end of this range.

⁸ The successful tenderer also included set-up costs within its tender submission, based on actual costs incurred that would be capped at one per cent of committed funds (ie, up to a maximum of £500,000, based on the assumption of a £50 million fund). The Panel's evaluation had rightly omitted these set-up costs from its consideration, as such costs were outside the scope of the ITT. However, and inexplicably, a set-up fee of £500,000 was subsequently included by Finance Wales within the successful tenderer's contracts. This is considered in further detail in [paragraphs 1.37 to 1.41](#).

- 1.26 Internal Audit also identified poor and incomplete documentation of the individual tender assessments by the members of the Panel (other than for the actual scores that each of them had awarded). Specifically, they found a lack of any documentation of discussions between members to confirm that some of the markedly different individual scores recorded (for example, with regard to their widely differing views of the bidding companies' track records) were explored and challenged, thereby demonstrating how an overall agreed score for each tenderer had been reached.
- 1.27 Internal Audit established that the financial due-diligence checks by Finance Wales were irrelevant as they had been undertaken in February 2013 on a different company⁹; and for only one year's accounts of that company (being the year to 31 March 2011, owing to a lack of more recent accounts). In addition, this due-diligence checking process had only been conducted some four months after notifying the successful tenderer of the outcome of the process. In our view these actions were clearly flawed, in that the company's accounts were not relevant to the business of the successful tenderer and, even if they had been relevant, were reviewed far too late in the process.
- 1.28 Internal Audit found that the Procurement Panel had failed to establish (through basic due-diligence checks) that most¹⁰ of the 'Directors' named within the successful tender were not in fact Directors of the company at the date that the tender was submitted. Those appointments were made subsequently. The Fund Manager told us that it had made clear to Finance Wales at the time of the bid that it would only be appointing most of the Directors named in the tender if successful; and that this intention was unsurprising given that the company had been newly formed specifically for the Fund.
- 1.29 Further to Internal Audit's findings, we found that both the ITT and the subsequent procurement of a fund manager had failed to consider and evaluate the possibility of any arrangement (or similar) fees that the bidding companies might propose to charge on an investee company; and neither of the two tenders had included provision for levying any such fees. Fees of this nature, which we understand are standard industry practice for the private-equity market, are covered in [paragraphs 1.83 to 1.93](#).
- 1.30 Given the above findings, we consider there were significant shortcomings in the procurement of the Fund Manager by Finance Wales. The Internal Audit Review raised a number of recommendations in this area that are set out within [Appendix 2](#), together with management's responses to them.

⁹ The due diligence checks were conducted in February 2013 on the 2010-11 audited accounts of Excalibur Group Holdings Ltd, a company unrelated to Arthurian (although also owned by Sir Christopher Evans).

¹⁰ Eight of the 10 purported Directors were not registered at Companies House until 1 July 2013, some 10 months after the procurement process had been concluded and some four months after the Fund Manager contracts had been signed.

Neither the Welsh Government nor Finance Wales are able to provide adequate justification for the totality of their payments to the successful tenderer under the interim arrangements

- 1.31 Although Finance Wales notified the successful tenderer on 27 September 2012 (with the legally-required 'standstill period' ending on 8 October 2012) of the outcome, the company could not commence managing the Fund until it had first obtained authorisation with the Financial Conduct Authority (FCA). This authorisation was essential because the Fund Manager would be conducting FCA-regulated activities. The successful tenderer obtained FCA authorisation on 16 January 2013. However, the contract was not ready for signing until 28 February 2013.
- 1.32 On 31 October 2012, Finance Wales therefore put in place an interim Fund Management Agreement to enable Finance Wales itself to operate the Fund. This interim Agreement ceased on 28 February 2013, once the successful tenderer had signed its contracts.
- 1.33 The interim Agreement was between two Finance Wales subsidiary companies; these were Finance Wales Investments (9) Ltd (FWI 9) and Finance Wales Investments Ltd (FWI). FWI acted as the interim Fund Manager. These arrangements were created solely for the purposes of the Fund, pending the successful tenderer's FCA authorisation and the signing of its contracts. The agreement stated that FWI was responsible for identifying and evaluating investment opportunities, making recommendations on investments, and monitoring the portfolio of such investments. FWI recommendations would be considered by FWI 9's Investment Committee, which would provide independent challenge and scrutiny of an investment proposal prior to its approval or rejection. The Investment Committee comprised three voting Members; these were a Finance Wales Director and two Directors of the successful tenderer. (The successful tenderer, as an entity, did not feature in the interim Agreement.)
- 1.34 For the period 31 October 2012 to 28 February 2013, under the terms of the interim Agreement, the FWI 9 Investment Committee considered just one investment proposal. This related to a life sciences company in which the Investment Proposal Paper (IPP) recommended a £1 million investment from the Fund. At its 30 January 2013 meeting, the Investment Committee approved this investment. However, the company subsequently rejected the investment offer.
- 1.35 Between October 2012 and April 2013 both the Welsh Government and Finance Wales made 'interim' payments to the successful tenderer, the details of which are set out within [Appendix 1](#). These interim payments were not covered by the fund management contracts that were signed by Finance Wales and the Fund Manager on 28 February 2013, and comprised the following components:
- a a fee of £500,000 in respect of set-up costs (provided on a loan basis during the interim period);

- b the payment of fees in place of the (yet to be contracted) management fees; and
- c a loan of £260,000 to help with cash flow.

1.36 The results of further consideration of these payments by the Wales Audit Office are set out below.

Set-up costs were paid at £500,000 on a flat-fee basis, the basis of which Finance Wales had not documented and its officials could not explain

1.37 Although set-up costs were not part of the ITT (see [paragraph 1.24](#) and [footnote 8](#)), the successful tenderer had included provision for them within its tender as it considered them to be standard market practice, proposing that these should be based on actual costs incurred with a cap set at one per cent of committed funds of £50 million (ie, up to a maximum of £500,000). The other bidding company had excluded such costs from its tender. The successful tenderer told us that they considered their intention to have been clearly stated in their tender submission, which, in their view, had been based on a flat £500,000 fee, or one per cent of the Fund size. The Fund Manager provided us with evidence to support its contention that this percentage rate was standard practice within the marketplace.

1.38 The contracts that were signed on 28 February 2013 provided for a flat-fee payment to the Fund Manager of £500,000 in respect of its set-up costs. Finance Wales did not document, and was unable to explain to us:

- a its rationale for agreeing to the contractual inclusion of a set-up fee;
- b why it considered a set-up fee of £500,000 to be appropriate; and
- c why it agreed to make a flat-fee payment, rather than accepting the successful tenderer's proposal for the reimbursement of its actual (capped) costs incurred.

1.39 Shortly after the successful tenderer had been notified (in October 2012) of the outcome of the tender, the company sought payment of £500,000 for its set-up costs. Finance Wales declined this request because there was at that time no contractual basis for such a payment. However, Finance Wales did agree to provide a loan to the successful tenderer of £480,000 on commercial terms, in lieu of the set-up costs that Finance Wales envisaged paying once the successful tenderer had secured FCA authorisation and had signed its contracts. On this basis, on 13 November 2012 Finance Wales loaned £480,000 to the successful tenderer.

1.40 Subsequently, on the signing of the fund manager contracts on 28 February 2013, the £500,000 that had by then become contractually due to the Fund Manager was set against repayment of the £480,000 loan plus the interest of £10,641 charged by Finance Wales on its £480,000 loan (see [Appendix 1](#)).

1.41 This loan had left Finance Wales exposed to the risk of default, in the event that the successful tenderer subsequently had not been awarded the Fund Manager contract (a scenario that could have arisen in the event that the company had been unable to secure FCA authorisation). While the loan had been secured on the successful tenderer's assets, its audited accounts to 31 March 2013 suggest that the company had insufficient net assets to support repayment of the loan, had that proven necessary. However, Finance Wales's officials had judged the possibility of the successful tenderer not gaining FCA authorisation to have been very low. The Fund Manager told us that it had offered Finance Wales security in the form of its deal-flow database which would have been beneficial to another fund manager, and to Finance Wales.

Interim payments were made, in lieu of the contracted management fees which, despite the lack of FCA accreditation, were based closely on the 2.5 per cent of committed funds that would have been in place had contracts been signed when originally intended

1.42 During the period of the interim arrangements (October 2012 to 28 February 2013), the successful tenderer received payments from Finance Wales and the Welsh Government that were close in their total value to 2.5 per cent of a £50 million commitment¹¹. Welsh Government officials told us that they were content to pay management fees based on a £50 million fund during the interim period in order to maintain a team capable of managing this type of fund.

1.43 Finance Wales paid the successful tenderer £207,600 (comprising £173,000 paid in October 2012, plus VAT paid in February 2013) in respect of due diligence activity for deals in the pipeline as at 31 October 2012. The value of this payment equated to the maximum management fee payable under the circumstances, according to legal advice obtained by Finance Wales.

1.44 Having made payment of the £207,600 and the loan of £480,000, the Board of Finance Wales determined that they would not approve any further payments to the successful tenderer without Ministerial confirmation from the Welsh Government. On 11 January 2013 the Board's reasons were set out formally to the Welsh Government's Director General for Economy, Science and Transport (as the responsible Accounting Officer), by Finance Wales's Group Investment Director.

1.45 Finance Wales did not receive the Ministerial confirmation requested and the Welsh Government instead determined to pay the successful tenderer directly. Further to Finance Wales's payments, the Welsh Government itself paid the successful tenderer £370,800, which it saw as being a very close equivalent of three months' management fees based on 2.5 per cent of £50 million committed funds. We understand that these payments were made to the successful tenderer to finance the costs of work on potential investments by the Fund, known by Welsh Government officials as 'pipeline deals'.

¹¹ Committed funds stood at £25 million until 25 February 2013 (three days prior to the signing of the Fund Manager contract). On 25 February, the Welsh Government increased its committed funds to £50 million.

- 1.46 Whilst these interim payments were made to the successful tenderer by both Finance Wales and the Welsh Government, the successful tenderer had no contractual role until 28 February 2013 when its contracts were signed ([paragraph 1.31](#) refers). [Appendix 1](#) shows that the payments to the successful tenderer were only some £32,000 less than the company would have received, had the Fund Manager contract been signed when originally intended (based on committed funds of £50 million). Neither the Welsh Government nor Finance Wales could explain to our satisfaction:
- a the reasons for the totality of their payments to the successful tenderer under the interim arrangements; or
 - b why no deductions were made, to allow for the fact that the successful tenderer was legally unable during that period to perform one of the key functions of a fund manager (undertaking FCA-regulated investment activities).
- 1.47 Welsh Government officials told us that there had been a strong case for proceeding on this basis, as in their view the reason for the various interim payments had been brought about by events unforeseeable by, and not attributable to, the Welsh Government. The officials explained that they had judged that not paying the successful tenderer these sums could (i) have delayed the exploitation of the Fund; (ii) risked a loss of continuity with the generation of ‘leads’; and (iii) delayed the implementation of the proposed Life Sciences Hub¹². Officials also emphasised their assessment of the risk of losing public relations and promotional activity relating to the life sciences sector in Wales, and also their need to mitigate the risk that the contract would either not proceed at all, or else inevitably be delayed by a re-procurement.

The Welsh Government has been unable to provide evidence to support the basis of either the value or the terms of their April 2013 loan of £260,000 to the Fund Manager

- 1.48 In April 2013, the Welsh Government made a loan of £260,000 to the Fund Manager to cover its cash flows. The loan had a capital and interest ‘holiday’ of 27 months to July 2015, and thereafter an interest rate of 8.5 per cent over the subsequent 16 quarters to November 2019.
- 1.49 The relevant Ministerial submission stated that the loan was intended to reflect the cash position that would have been anticipated if the Fund Manager arrangements had operated as intended from the outset. Extracts of the Ministerial submission recorded that:
- a ALS [Arthurian] succeeded in winning the tender to run the Fund in October 2012, but contractual negotiations and the fact that ALS were not registered with the Financial Services Authority [now the Financial Conduct Authority] has meant that the fund management contracts were not signed until the 28 February 2013. This has meant ALS has been unable to draw any fund management fees from Finance Wales under the contract over this period.

¹² The Life Sciences Hub is based in Cardiff Bay. Its website explains that it is the focal point for the life sciences sector in Wales, seeking to stimulate interaction, innovation, networking and collaboration. More details can be found on the [Life Sciences Hub website](#).

- b 'Further to the development of a pipeline of opportunities, ALS also need to attract up to £50 million of support from private sector investors to co-invest in the [Welsh Government's] life science fund and this will be dependent on the effectiveness of ALS and the robustness of its cash position.'
- 1.50 Given that the contract was in place from 28 February 2013, some two months prior to the loan being granted, it is difficult to understand why a loan would have been needed for cash flow purposes through to late 2016. Welsh Government officials told us that they had been advised by the Fund Manager that the loan was required to obtain the support of private-sector investors, and that they had no evidence on which to dispute this. However, the Welsh Government has been unable to provide us with any evidence supporting the basis of the calculation of the £260,000 loaned.
- 1.51 The Fund Manager told us that they considered the loan to have been provided on a commercial basis and that it had been provided for work done in the interim period prior to contracts being signed; for the fund set-up and documentation; building of a deal-flow database of potential investments; evaluation of opportunities; marketing of the fund; and initial asset raising efforts. They also told us that this was to ensure that fund management activity was well under way, not from the time the contracts were signed, but from the time the mandate was awarded, to the benefit of the Welsh Government, the Life Sciences Sector, and Wales.
- 1.52 Welsh Government officials told us that, while not documented, one of the reasons for the loan had been that due to the delay in starting the contract the Fund Manager had been unable to collect any arrangement fees through investments approved.
- 1.53 The Ministerial submission recorded that there were no novel or contentious issues arising with regard to the loan and that therefore the submission did not require clearance with the Corporate Governance Unit. However, Welsh Government officials had sought the views of the Head of Corporate Governance and Assurance, who was content for the submission to the Minister for Economy, Science and Transport to be submitted because he considered that it highlighted the principal benefits, risks, and mitigating actions. We note that any risk to the Welsh Government of a default on repayment could be readily addressed via a commensurate reduction in the monthly fund-management fee paid by Finance Wales. However, repayments commenced on schedule in July 2015 with the final repayment due to the Welsh Government in 2019.

The oversight arrangements put in place by Finance Wales were insufficiently robust, and as a result one aspect of the investment in ReNeuron Plc was not handled in accordance with the Fund Management contracts

- 1.54 In April 2013, the Fund made its first investment, of £750,000 in Simbec Ltd. We have examined this investment and are satisfied that it was appropriately managed by all concerned. We comment further regarding the associated arrangement fees for this investment within [paragraphs 1.83 to 1.93](#).
- 1.55 The second investment made by the Fund was in ReNeuron Plc (ReNeuron), a company listed on the Stock Exchange's Alternative Investment Market (AIM) that was seeking a significant funding injection from a range of sources. The Fund Manager's Investment Committee considered and approved the investment on 26 June 2013. The minutes of the meeting record that three attendees had conflicts of interests and would therefore abstain from voting. The minutes also recorded that Sir Christopher Evans did not attend the meeting as he had a conflict of interest because he had already provided an opinion to the Welsh Government on whether to award a grant to ReNeuron (see [paragraph 1.66](#)).
- 1.56 While the Fund Manager does have autonomy in selecting and considering investment proposals, a fundamentally important contractual (and hence explicitly acknowledged) obligation is that the Fund Manager must notify Finance Wales of any conflicts of interest prior to the commitment to invest and the subsequent drawdown of Fund monies. However, we established that the Fund Manager had not notified Finance Wales of the conflicts that existed within the company with regard to the ReNeuron investment until we drew them to the attention of Finance Wales as a result of our audit, at which point its officials then sought clarification from the Fund Manager.
- 1.57 Separately, Sir Christopher Evans had appropriately disclosed his private investment in ReNeuron to the Welsh Government because the Welsh Government was due to appraise an application for financial support from ReNeuron (see [paragraphs 1.63 to 1.67](#)). Welsh Government officials did not forward this disclosure to Finance Wales themselves, as they had expected the Fund Manager to make a separate (and contractually-required) disclosure to Finance Wales of any ReNeuron-related conflicts. While the Fund Manager has satisfied us that all conflicts were appropriately disclosed under its own internal policies, they told us that this was only the Fund's second investment and the flow of information to Finance Wales was still being detailed and refined.
- 1.58 We established that in January 2015 Finance Wales and the Fund Manager introduced an improved 'investment request form' that includes all relevant and contractually required details. We understand that this revised form has been used since the Fund's seventh investment.

- 1.59 Finance Wales's internal processes did not require its officials to undertake checks on whether the Fund Manager's actual governance arrangements for the Fund complied with the contractual requirements in respect of the handling of conflicts. Finance Wales confirmed to us that such checks had not been undertaken because the Fund Manager has significant autonomy under the contractual terms, and they had simply presumed that the Fund Manager would comply with all of the terms in place. We consider that Finance Wales's contract management arrangements failed to provide adequate oversight and sufficient checks on investments for which the Fund Manager had sought investment monies from the Fund.
- 1.60 When Finance Wales realised (as a direct result of our audit review) that the Fund Manager had not reported its ReNeuron conflicts as required, its Group Investment Director emailed the Fund Manager's Chief Executive to remind him of the Fund Manager's contractual obligations to Finance Wales for the handling and notification of conflicts.
- 1.61 We also note that, whilst the Fund Manager's Investment Committee had approved on 26 June 2013 an investment of £4 million in ReNeuron, the Fund had subsequently invested a total of £5 million in the company, which was drawn down from Finance Wales on 6 August 2013. The Fund Manager did not provide any documentary evidence to support this increase (such as subsequent minutes of the Investment Committee), but it did advise us that the investment had increased to maintain the Fund's percentage stake, because ReNeuron's placement of shares had proven to be very successful. If stronger contract management had been in place within Finance Wales, we would have expected this change in the investment value to have been questioned by Finance Wales at the time.
- 1.62 The Wales Audit Office does not have in-house expertise of 'AIM Rules for Companies'. Therefore, in order to inform our audit review we commissioned specialist expertise from Grant Thornton LLP to review the Fund's 2013 investment in ReNeuron. Grant Thornton identified a small number of possible AIM reporting errors, but considered that none of these were material to their review. Having completed its work Grant Thornton was able to confirm to the Wales Audit Office that, apart from the immaterial possible reporting errors, they were not aware of any possible breaches of the AIM Rules or other relevant laws or regulations that were relevant to their review.

Alongside the Fund's investment in ReNeuron Plc, the Welsh Government's award of in-principle financial support to ReNeuron did not comply with its usual business processes, and it is not possible to confirm whether it handled appropriately a clear conflict of interest that had been declared to it

The Welsh Government may not have handled an important declared conflict of interest appropriately

- 1.63 Internal Audit examined the governance arrangements applied by the Welsh Government in awarding financial support totalling £7.8 million to ReNeuron (see paragraphs 1.68 to 1.78), which was separate to the Fund's investment of £5 million.
- 1.64 They found that the Head of Compliance within the Department for Economy, Science and Transport had provided sound and explicit advice on the handling of the conflict that Sir Christopher Evans had declared in respect of an existing financial interest in ReNeuron¹³. The Head of Compliance had advised that Sir Christopher Evans should be excluded from the decision-making process relating to the provision of potential support to ReNeuron, and communicated this to the Department's relevant officials.
- 1.65 Notwithstanding this clear advice, during the period when Welsh Government officials were considering funding to ReNeuron, Welsh Government records show that officials were in regular contact with Sir Christopher Evans by email and in meetings. Although these meetings were not always documented by Welsh Government officials, they have strongly maintained to us throughout our study that there is no evidence that any contact had a material outcome on any decisions taken.
- 1.66 Further to the Welsh Government records, the minutes of the Fund Manager Investment Committee's meeting on 26 June 2013 (see paragraph 1.55) record that:

'Professor Sir Chris Evans, in his capacity as adviser on Life Sciences to the Welsh Government (WG) was asked to give opinion on the company [ReNeuron] to enable WG to reach a decision as to whether to award a grant to the company during a recent grant application process. As such he [Sir Chris Evans] feels that having advised¹⁴ WG in one respect he should recuse himself from all discussions on an investment by the Fund and will not be attending the meeting, contributing to discussions, making recommendations nor voting on the matter.'

¹³ Excalibur Group Holdings Ltd, controlled by Sir Christopher Evans, is the owner (but not controller) of the General Partner of Merlin Biosciences Fund LP and Gbr (MBF), a fund in liquidation since February 2012. MBF, managed and controlled by a liquidating trustee, in June 2013 held 74 million shares in ReNeuron.

¹⁴ As reported at paragraph 1.4, Sir Christopher Evans had resigned from the Life Sciences Sector Panel on 19 February 2013. Therefore, when the Arthurian Investment Committee had met on 26 June 2013 Sir Christopher Evans no longer held an advisory role to the Welsh Government.

1.67 The Welsh Government has suggested to us the following reconciliation of these apparently conflicting positions: that whilst Sir Christopher Evans may genuinely have believed that he had offered ‘advice’ to the Welsh Government on the grant award to the company (and hence felt it appropriate to recuse himself from the Investment Committee meeting), Welsh Government officials did not recognise his contribution as being advisory in that sense. However, we have concluded that it is simply not possible for us to confirm that the Welsh Government handled appropriately the conflict of interest that had been correctly declared to it.

The award of ‘in-principle’ Welsh Government support to ReNeuron was poorly handled by officials and the case for additionality was not fully considered

1.68 On 26 June 2013, the Welsh Government issued an ‘in-principle’¹⁵ grant offer letter to ReNeuron for Repayable Business Finance (RBF). The in-principle offer letter from the Welsh Government actually comprised a package of four financial and non-financial elements:

- a non-repayable business finance of £1.8 million;
- b training grant of £0.5 million;
- c research and development projects of £1 million; and
- d clean rooms and manufacturing facility support worth up to £4.5 million.

1.69 With regard to the non-financial support in [paragraph 1.68d](#), the costs to the Welsh Government of making these facilities available were not clear at the time the offer was made. Welsh Government officials confirmed to Internal Audit that efforts would be made to minimise these costs, which would be reflected in the commercial terms charged to ReNeuron for the lease.

1.70 Soon afterwards, ReNeuron requested a ‘firmer’ grant offer letter and, in response, on 12 July 2013 the Welsh Government issued a second grant offer letter that omitted the original reference to the offer being ‘in principle’. However, at that date the status of the offer had remained unchanged and so was still in fact ‘in principle’ only.

1.71 Welsh Government officials told us that they had to consider the ReNeuron grant application swiftly in order to secure the investment to Wales, if approved. However, the application form submitted by ReNeuron was incomplete, for example, both the proposed project expenditure and the intended financing were blank. Also, the Welsh Government’s usual business processes for RBF were not fully complied with, in order to expedite the approval of the application. Officials informed Internal Audit that there had been sufficient information in the appraisal documentation as it had been supplemented by correspondence and dialogue, which had enabled the ‘in-principle’ decision on the application to be taken. They also advised Internal Audit that it is not uncommon for application forms to be incomplete and for the required information to be provided by way of other supplementary documents.

¹⁵ ‘In-principle’ offers are sometimes used by the Welsh Government prior to the issue of a binding offer, pending the receipt of further information from the grant applicant to allow a final decision.

- 1.72 Due to the compressed timescale in which the Welsh Government had determined to consider the application, officials concluded that there was insufficient time to hold a full meeting of the Welsh Government's Welsh Industrial Development Advisory Board (WIDAB)¹⁶, in accordance with the usual business process. The Chair of WIDAB therefore agreed instead that as many WIDAB members as possible could attend a meeting of the Department for Economy, Science and Transport's Investment Panel¹⁷ so that the Minister could have the benefit of their advice when considering the submission. Five (of the then eight) WIDAB members attended the Investment Panel meeting of 18 June 2013, which endorsed the proposed financial support to ReNeuron. This was then approved by the Minister on 24 June and an 'in-principle' grant offer was made to ReNeuron on 26 June 2013 (see [paragraph 1.68](#)).
- 1.73 WIDAB next met on 24 October 2013, when it retrospectively ratified the appraisal of the ReNeuron application and the company's need to raise some £15 million. The appraisal was undertaken by one of the Department for Economy, Science and Transport's Senior Due Diligence Managers¹⁸. However, the financial position of ReNeuron had changed dramatically between the application and the appraisal, due to the highly successful share placement that had raised £25.35 million. Accordingly, the Senior Due Diligence Manager advised WIDAB that neither the case for meeting additionality criteria nor for supporting the level of funding to be offered (which was the maximum amount available under State Aid limits) had been proven.
- 1.74 Internal Audit noted that WIDAB were nonetheless satisfied that these issues had been resolved during the appraisal process. However, we understand that the subsequent decision to ratify the provision of the financial support was not recorded, aside from a handwritten note by the WIDAB secretariat that read: 'Additionality – retrospectively don't need it. Our money facilitates projects to happen even when the business has the money, our money accelerates the process.'
- 1.75 The Welsh Government's RBF Guidance clearly states that the Welsh Government should act as funder of last resort. In this instance, the availability of support formed part of the share offer prospectus and would have been a relevant consideration in helping potential investees to decide whether to purchase shares. Welsh Government officials told us that while the availability of in-principle RBF support may have been a relevant consideration by potential investees in deciding whether or not to purchase shares in ReNeuron in response to the share offer prospectus (which subsequently successfully raised the £25.35 million of equity investment), they had considered that the offer of RBF was necessary as part of a package to attract ReNeuron to Wales.

¹⁶ WIDAB consists of a panel of industrialists that provides independent advice to the Minister for Economy, Science and Transport on all investments over £1 million.

¹⁷ The Department's Investment Panel provides independent advice to the Minister for Economy, Science and Transport on investments below £1 million.

¹⁸ The Department's Senior Due Diligence Managers are qualified accountants who undertake financial due-diligence assessments of applications (and business plans) received that are seeking financial support. Based on their assessment they provide internal departmental advice on an application's validity.

- 1.76 Officials advised Internal Audit that whilst the compressed timescale for the consideration of the funding had resulted in the appraisal not being undertaken in accordance with the standard procedures and RBF guidance, nonetheless both the Investment Panel and WIDAB had been content to recommend approval (WIDAB retrospectively) of the application in order to secure this high-profile inward investment project for Wales.
- 1.77 Internal Audit raised two recommendations in this area:
- a The Department for Economy, Science and Transport should amend the governance arrangements for the appraisal of business finance applications to enable (on an exceptional basis) urgent consideration by the Investment Panel or WIDAB. Officials accepted this recommendation, with immediate implementation.
 - b The Department for Economy, Science and Transport should ensure that there is comprehensive record keeping to support both the consideration of investment cases by officials and WIDAB and the alignment of RBF applications with the Scheme's criteria. Officials accepted this recommendation, with implementation by 31 July 2014.
- 1.78 The Department has since amended the Sectors and Business Financial Approval Process in response to these Internal Audit recommendations, with governance arrangements now enabling (on an exceptional basis) the urgent consideration of applications for business finance. We therefore make no further recommendations of our own in this area.

Our review of the Fund's third investment found that conflicts of interest had been properly managed by all concerned, and to date Finance Wales has not identified any concerns regarding the handling of conflicts of interest in the Fund's subsequent investments

- 1.79 In March 2014, the Fund made its third investment, of £4.62 million in Verona Pharma Plc. We have not examined this investment in detail. We did, however, review Companies House records which confirmed that a Director of the Fund Manager is also a Director of Verona Pharma. Finance Wales have since confirmed and evidenced to us that the Fund Manager had met its contractual obligations by reporting the conflict, and its handling, to the satisfaction of Finance Wales, prior to the investment being made. Verona Pharma Plc paid the Fund Manager an arrangement fee of £150,000 plus VAT.
- 1.80 In July 2014, the Fund made its fourth investment, in Simbec-Orion Group Ltd, for £8 million. We have not reviewed this investment in detail. However, we reviewed Companies House records which confirmed that Simbec-Orion Group Ltd arose through a name change of Simbec Holdings Ltd (with effect from 26 June 2014). The Fund's fourth investment was therefore a further injection of funds to the recipient of the Fund's first investment (see [paragraph 1.54](#)).

1.81 Companies House records confirm that:

- a two Directors of the Fund Manager were appointed to Simbec Holdings Ltd in May 2013, after the Fund's first 'Simbec' investment in April 2013; and
- b that both of the Directors remained as Directors of Simbec-Orion Group Ltd, and were therefore Directors at the time of the Fund's investment in that company in July 2013.

1.82 Since August 2014, the Fund has made seven further investments (which we have not reviewed, as they were made after our audit fieldwork had concluded). **Exhibit 1** sets out the investments.

Exhibit 1 - The Fund's investments since August 2014

Month	Investment by the Fund
August 2014	In Medaphor Ltd for £0.6 million (the Fund's fifth investment).
November 2014	In Interrad Medical Incorporated, a US-based company, for £2.886 million.
April 2015	In Sphere Medical Holding Plc for £4 million.
June 2015	In Proton Partners Int Ltd for £10 million.
August 2015	In CeQur SA, a Swiss-based private company, for £3.36 million.
August 2015	A second investment by the Fund in ReNeuron Group Plc for £5 million.
September 2015	In Apitope International NV, a Belgium-based private company, for £3.9 million (the Fund's 11th investment).

Neither Finance Wales, nor indeed the Welsh Government, are currently able to exercise any contractual control over the arrangement fees charged by the Fund Manager, as the scope for levying such fees was overlooked during the procurement process

- 1.83 We established that the Fund Manager had secured arrangement (or negotiation) fees from both of the companies in which the Fund had made its initial investments in 2013. The fees payable by the investee companies to the Fund Manager were:
- a £500,000 plus VAT paid by ReNeuron Group Plc, a quoted company, with regard to the Fund's £5 million investment (representing 10 per cent of the Fund's investment value, or two per cent of the deal value); and
 - b £60,000 plus VAT paid by Simbec Ltd, a private equity company, with regard to the Fund's £750,000 investment (representing eight per cent of the Fund's investment value).
- 1.84 The levying of arrangement fees clearly reduces the financial capacity of the investee companies, which has potential adverse value-for-money implications because the ability of the investee company to generate jobs and growth (and/or a return to the Fund on its investment) is reduced. Alternatively, if the investment value itself were to be uplifted to cover the additional cost of the arrangement fee, so that the investee is held harmless, then this would reduce the remaining financial capacity of the Fund to invest elsewhere.
- 1.85 We observed that the potential for such arrangement fees had not been considered by either the Welsh Government or Finance Wales as part of the procurement of the Fund Manager (see [paragraph 1.29](#)). However, even though the procurement process had not covered the scope for such fees, and the tender documentation received from the bidding companies had also not covered such fees, we found that the signed contracts between Finance Wales and the Fund Manager nonetheless contain clauses that do permit such fees to be charged by the Fund Manager on investee companies.
- 1.86 This apparent anomaly had arisen as the wording of the Fund Manager contracts had been derived from existing Finance Wales contracts that were in place for a separate and unrelated investment fund. Finance Wales officials told us that they had been unaware of the level of the arrangement fees that had been charged by the Fund Manager until they were brought to their attention by our audit review. In our view, the level of arrangement fees proposed to be charged by each tenderer should have been a material consideration within the procurement process and subsequent contract management.

- 1.87 Regulation 30 of the Public Contracts Regulations 2006 sets out the criteria linked to ‘the subject matter of a contract’, which a contracting authority can take into account in determining the ‘most economically advantageous tender’. The criteria include ‘cost effectiveness’ as well as direct ‘price’ and ‘running costs’, which entitles a contracting authority to look beyond direct costs charged to it by a supplier. However, Welsh Government officials told us that in their view consideration of ‘cost effectiveness’ in respect to the levying of arrangement fees by the Fund Manager would have increased the risk of legal challenge. The Welsh Government officials confirmed that their view was not based on legal advice, but rather on their commercial experience in the development and management of contractual arrangements.
- 1.88 Given the importance of the arrangement fees to the subject matter of the Fund Manager contract, we asked Grant Thornton to advise on whether:
- a the fees charged by the Fund Manager represented typical industry-standard practice; and
 - b if the fees had represented standard practice, whether they had been in line with typical market rates.
- 1.89 Grant Thornton concluded that:
- a With regard to [paragraph 1.88\(a\)](#), the charging of arrangement fees was standard practice within the private equity market. However, they did not consider that the level of the fee for the ReNeuron investment, as an arrangement fee, was in line with market practice, particularly as it was in respect of a placing by a publicly quoted company, although they understood that the fee may have been for services that would more accurately be described as corporate finance services and would not normally be covered by an arrangement fee.
 - b With regard to [paragraph 1.88\(b\)](#), while the fee percentage paid to the Fund Manager by Simbec had been high, given the small size of the investment the absolute cost of £60,000 did not appear excessive for a private equity company, and might have reflected the fact that this was a small investment and that further capital might follow.
- 1.90 Subsequent to the Grant Thornton review, we have identified that the Fund Manager levied an arrangement fee of £150,000 plus VAT on Verona Pharma Plc, the Fund’s third investment, representing 3.3 per cent of the investment value.
- 1.91 The Fund’s fourth to eleventh investments (see [paragraphs 1.80 to 1.82](#)) were made after our detailed audit fieldwork had been completed. We have therefore not ourselves sought to establish whether arrangement fees were also levied by the Fund Manager on these eight investments. We have, however, referred to this within our recommendations to the Welsh Government regarding those

investments (see [Recommendations 6 and 7](#)). The topic of arrangement fees levied by contracted fund management companies in respect of public investments was considered by the Committee of Public Accounts in the Westminster Parliament in 2006. In its report¹⁹ on the Local Enterprise Development Unit of the Northern Ireland Government's Department of Enterprise, Trade and Investment, that Committee examined a range of issues, some of which have a strong parallel with the oversight and operation of the Wales Life Sciences Investment Fund. Notably, the Northern Ireland Government's formal response²⁰ to the 2006 report contained the following undertaking:

'To...emphasise the independence of the fund manager role, all future legal agreements establishing venture capital funds to which [the Department] and its NDPBs contribute funding, will contain an express prohibition on the fund manager, or any staff employed by the fund manager, holding shares in private investee companies. It will also be forbidden for a fund manager to charge fees for services provided to investee companies beyond those set out in the tender which resulted in the award of the contract to manage the fund.'

- 1.92 With regard to the Committee of Public Accounts' reference to the independence of fund managers and their holding personal investment in investee companies, we note that Finance Wales itself operates robust internal controls that bar its own employees from investing personally in investee companies. Finance Wales's employees are occasionally appointed as Directors of investee companies (but only with the prior consent of the Chief Executive of Finance Wales), and they receive no additional remuneration for this from either Finance Wales or the investee business. In contrast, in a commercial fund, it is common for investors to expect the fund manager to share the investment risk, most obviously by having his or her own money at risk alongside that of the investor. We note that the Fund documentation specifically encourages staff of the Fund Manager to personally invest in shares of companies in which the Fund has invested.
- 1.93 We consider that Finance Wales should seek to agree with the Fund Manager a contractual basis for the calculation and levels of future arrangement fees, and recommend accordingly.

¹⁹ HC918: **Governance issues in the Department of Enterprise, Trade and Investment's former Local Enterprise Development Unit**, Committee of Public Accounts 46th Report of 2005-06.

²⁰ Cmnd 6879: **Northern Ireland Department of Finance and Personnel Memorandum on the 46th Report from the Public Accounts Committee Session 2005-06**, July 2006, page 11.

By opting to relinquish its contractual right to remove the Fund Manager without cause, Finance Wales has reduced its ability to exercise control over the fund management contract, and undermined its own legal power to intervene on arrangement fees

- 1.94 Under the Fund Management contracts between Finance Wales and the Fund Manager that were signed on 28 February 2013, Finance Wales had the contractual right to remove the Fund Manager 'without cause'²¹. This empowered Finance Wales to procure another fund manager, or indeed to bring the function in house.
- 1.95 On 25 March 2014, Finance Wales and the Fund Manager signed a Variation Agreement under which Finance Wales relinquished its right to remove the Fund Manager without cause. We were informed that this agreement was made at the request of Finance Wales itself in order to reduce its control over the Fund Manager, with the sole aim being that the Fund's financial results would not need to be consolidated into the annual accounts of Finance Wales Plc. Finance Wales officials told us that while the signed contracts had included the provision to remove the Fund Manager without cause, they had held doubts as to whether this clause would be legally enforceable.
- 1.96 We are unconvinced that an accounting rationale of this nature represents sound grounds for a public body to opt to weaken its ability to performance manage a contractor charged with the delivery of public services on its behalf. The existence of the Variation Agreement reduces the ability of Finance Wales to leverage good value for money from the Fund management contract in the future. Specifically, it is also likely to hamper Finance Wales in its endeavours to comply with **Recommendation 8** (arrangement fees) within this report.
- 1.97 Welsh Government officials confirmed to us that they had been aware of discussions between Finance Wales and its external auditors concerning a variation agreement; but had not seen the Variation Agreement itself until after it had been signed, when Finance Wales forwarded a copy to them.

²¹ The Fund Management agreement also contains provision for the removal of Arthurian with 'cause'; such causes include fraud, negligence, wilful default or breach of contractual conditions.

The Welsh Government is yet to determine the extent to which it expects private sector entities that are contracted to manage and deliver public services on its behalf to comply with the Nolan Principles

- 1.98 During the course of this audit review, we have discussed at length with Welsh Government officials the extent to which its relationships with private sector entities that are contracted as agents of government to manage and deliver public services should be governed in accordance with 'Nolan Principles'. These are more formally known as the Seven Principles of Public Life which were established in 1995 by the Committee on Standards in Public Life²² and accepted then and since by the UK Government and the devolved administrations.
- 1.99 The 'Nolan Principles', set out in [Exhibit 2](#), capture the basis of ethical standards expected over the stewardship of public monies.

Exhibit 2 - The Nolan Principles of conduct in public life

The **Seven Principles of Public Life**, known as the 'Nolan Principles', were originally defined within the First Report of the Committee on Standards in Public Life, May 1995.

The principles are:

- **Selflessness:** Holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other benefits for themselves, their family or their friends.
- **Integrity:** Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might seek to influence them in the performance of their official duties.
- **Objectivity:** In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.
- **Accountability:** Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.
- **Openness:** Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands it.
- **Honesty:** Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.
- **Leadership:** Holders of public office should promote and support these principles by leadership and example.

²² The Committee on Standards in Public Life is an advisory non-departmental public body. See more information on the [Committee's website](#).

- 1.100 The applicability of the Nolan Principles to private-sector entities that are contracted as agents of government to manage and deliver public services has not previously been considered in detail by the Welsh Government. This is not a straightforward matter, as in particular there are some real practical difficulties in the application of the Nolan principle of 'selflessness' to a profit-making entity. It is also an issue that the UK Government is currently grappling with²³. The stance taken by the Northern Ireland Government in response to a previous recommendation of the Westminster Committee of Public Accounts is also of relevance here (see [paragraph 1.91](#)).
- 1.101 However, it is important that the Welsh Government should provide clear guidance to its own officials, to its arms-length bodies (including Finance Wales and the various Welsh Government Sponsored Bodies) and also more widely across the Welsh public sector as to its expectations in this regard. In developing such guidance the Welsh Government may find it helpful to have regard to a recent report²⁴ by the National Audit Office, **Conflicts of Interest**. Once a settled position is established by the Welsh Government, that guidance should include a requirement that appropriate specific conditions are included in future contracts for the provision of public services in Wales.
- 1.102 We note two relatively recent reports of the Committee on Standards in Public Life. Firstly, the Committee's report, **Standards Matter**²⁵, which was published in January 2013. With regard to governance and the ethics of outsourcing, we draw attention to the following key extracts from the report:

'There is a growing area of ambiguity occupied by people contracted to deliver public services who may not be public office-holders. We strongly believe that the ethical standards captured by the seven principles should also apply to such individuals and their organisations. Like traditional public servants they are being paid public money to provide services on behalf of the community to individuals who may not have a choice about going elsewhere.

'Principles are what matters in determining what people "should" do as opposed to what they might "get away with". But the more ambiguous the circumstances (that is the less the principles might seem to an individual to be clearly applicable) the less purchase they are likely to have. This seems likely to be particularly important in the case of non-traditional suppliers of public services. Unless the principles are clearly translated into contracts and clear guidance, it is unlikely that private contractors in particular will believe that they are unambiguously applicable to them (given the likelihood of conflicts between the motives of private profit and public service), or spend time deducing from the principles how they are supposed to behave. There is therefore a responsibility on public office-holders to specify particular and proportionate ethical requirements in the contracts they let on behalf of the public sector. This is a difficult area, the implications of which will require some effort to work out in practice. It is an issue of possible future inquiry for the Committee.'

²³ For example, the Westminster Parliament's Committee of Public Accounts addressed this issue in its November 2014 report: **Out of Hours GP services in England** (22nd Report of Session 2014-15).

²⁴ **Conflicts of Interest**, report by the National Audit Office, 27 January 2015 (HC 907 of Session 2014-15).

²⁵ **Standards Matter**, 14th report by the Committee on Standards in Public Life, 17 January 2013 (Cmnd 8519).

1.103 Secondly, the Committee's report, **Ethical standards for providers of public services**²⁶, which was published in June 2014. We endorse the Committee's recommendations contained in its report, two of which are especially pertinent to the matters covered within this audit report:

- a 'Accounting Officers²⁷ should actively seek assurance that public money is being spent in accordance with the high ethical standards expected of all providers of public services; and
- b 'Accounting Officers should annually certify that they have satisfied themselves about the adequacy of their organisation's arrangements, based on formal assurance from providers of their acceptance of the necessity of ethical standards in the delivery of public services.'

1.104 Ultimately, and as reported by the Committee's Chair, Lord Bew: 'any organisation providing any public service should ensure that such standards form part of its culture and behaviour and are demonstrated in practice from start to finish'. The Auditor General strongly endorses this sentiment and considers that, in its contracted role as Fund Manager, Arthurian is providing a public service.

²⁶ See: **Ethical standards for providers of public services**, Committee on Standards in Public Life, 17 June 2014.

²⁷ In this case, the Welsh Government's Additional Accounting Officer for the Economy, Skills and Natural Resources Group (as the Chief Executive of Finance Wales does not hold an Accounting Officer designation).

Appendices



Appendix 1- Summary of payments made to the Fund Manager under the ‘interim arrangements’

As explained in paragraphs 1.31 to 1.53 of the report, between October 2012 and April 2013 the Welsh Government and Finance Wales made payments to Arthurian (the Fund Manager) under ‘interim arrangements’ that operated until 28 February 2013, pending the company’s authorisation with the Financial Conduct Authority.

The summary table below compares:

- Columns A and B – the schedule of payments that would have been due to Arthurian from Finance Wales between October 2012 and 28 February 2013, had the fund management contracts been in place from 8 October 2012 as originally intended; and
- Columns C and D – the actual payments made by the Welsh Government and Finance Wales to Arthurian between October 2012 and April 2013 under the ‘interim arrangements’.

Month	(A)	(B)	(C)	(D)
	Payments that would have been due to 28 February 2013, had the contracts been in place as planned from 8 October 2012		Actual payments made under the interim arrangements	
	By month (£)	Cumulative (£)	By month (£)	Cumulative (£)
October 2012	577,285	577,285	173,000	173,000
November 2012	104,167	681,452	480,000	653,000
December 2012	104,167	785,619	0	653,000
January 2013	104,167	889,786	179,419	832,419
February 2013	104,167	993,953	26,581	859,000
March 2013	–	–	103,000	962,000
April 2013 [loan]	–	–	260,000	1,222,000
Total		993,953		1,222,000

Notes:

- 1 Columns C and D include the loan of £260,000 provided to Arthurian by the Welsh Government in April 2013, which is repayable over 18 months from August 2015 (see paragraphs 1.48 to 1.53 of the report).
- 2 Since 28 February 2013, and in accordance with the agreed contractual terms, Finance Wales has paid Arthurian a monthly management fee of £104,167 (this being one-twelfth of 2.5 per cent of £50 million).
- 3 The payments shown in the summary table exclude the arrangement fees secured by Arthurian from investee companies.
- 4 All figures shown in the summary table exclude VAT.

The following tables provide further details of the payments made by Finance Wales and the Welsh Government under the 'interim arrangements'.

Payments made by Finance Wales

Date	Amount (£)	Description within Finance Wales's records
31 October 2012	173,000	'Due diligence payment.'
See below ²⁸	489,359	'Set up costs.'
12 February 2013	34,600	'VAT on the payment made on 31 October 2012.'

Payments made by the Welsh Government

Date	Amount (£)	Description within the Welsh Government's records
15 January 2013	103,000	'Services in connection with the Welsh Fund management, operation and target leads. Market data and analysis for the period 1 December 2012 to 1 January 2013.'
13 February 2013	20,600	'VAT on the payment made on 15 January 2013.'
31 January 2013	76,419	'Mapping of the Life Science Wales's eco-system, market analysis, detailed analysis of those prospects likely to generate significant benefits to Wales Life Sciences sector, and preparing PR material. 1 January – 23 January 2013.'
13 February 2013	15,284	'VAT on the payment made on 31 January 2013.'
25 February 2013	26,581	'As for 31 January payment – period covered 24 January to 31 January 2013.'
25 February 2013	5,316	'VAT on the payment made on 25 February 2013.'
21 March 2013	103,000	'As for 31 January payment – for period 1 February to 28 February 2013.'
21 March 2013	20,600	'VAT on the payment made on 21 March 2013.'
18 April 2013	260,000	'Loan to Arthurian, reflecting the cash position that would have been anticipated if the fund had been set up and operational as per the original timescales.'

²⁸ Net amount paid by Finance Wales to Arthurian, based on loan payments and associated receipts in November 2012 and February 2013.

Appendix 2 - Welsh Government Internal Audit recommendations (extracted)

Recommendation	Management Response
<p>A lessons learned exercise should be undertaken to ensure that procedures are strengthened in WG and FW to ensure that policies and procedures are amended to prevent any re-occurrence. The exercise should include consideration of how Nolan Principles should be applied.</p>	<p>Accepted</p> <p>Management agree to prepare and issue a lessons learned report. [see Appendix 3]</p> <p>Additionally, management have instructed Finance Wales to provide an annual report on the performance of Arthurian against the objectives set.</p> <p>Within Finance Wales a meeting of those involved in the procurement process will be held and actions arising from this report will be noted.</p> <p>Target Implementation Date:</p> <p>31 July 2014 (with implementation/ embedding of lessons learned by October 2014).</p>
<p>The Sector Panel Team should remind Sector Panel Members of the need to declare conflicts of interest as they arise and provide members with guidance on what would constitute a conflict.</p>	<p>Accepted</p> <p>The Sector Panel has been presented with a paper by management which sets out what is meant by a conflict and the process to manage such conflicts.</p> <p>Target Implementation Date:</p> <p>Immediate.</p>
<p>The Sector Panel team should confirm the existence or absence of declarations of interest at each Sector Panel meeting and record the results, along with any mitigating actions necessary, in the meeting minutes.</p>	<p>Accepted</p> <p>Management require each Sector Panel to have conflicts of interest as the first material agenda item at every Panel meeting and have reminded Sector Chairs and Panel Secretariats accordingly.</p> <p>Target Implementation Date:</p> <p>Immediate.</p>
<p>FW should review the Limited Partnership Agreement and Fund Management Agreement with Arthurian to ensure that they accurately reflect the responsibilities of each party, and are consistent with the tender specification and bid for the Fund Manager contract.</p>	<p>Accepted</p> <p>This is currently in progress and a new draft agreement has been sent to Arthurian.</p> <p>Target Implementation Date:</p> <p>31 July 2014.</p>

Recommendation	Management Response
<p>Any further disclosures received by WG in respect of Arthurian in their capacity as Fund Managers of the Wales Life Sciences Investment Fund should be returned to Arthurian with a clear instruction to refer the disclosure to FW in line with the LPA.</p>	<p>Accepted This has already been implemented. Target Implementation Date: Immediate.</p>
<p>Where conflicts of interest are identified, the Department for Economy, Science and Transport should ensure that appropriate records of meetings that may be perceived as related to the disclosure are maintained to demonstrate that conflicts of interest are appropriately managed.</p>	<p>Accepted An instruction has been issued and minutes of Sector Panel meetings will contain appropriate references to the management of any conflicts of interest. Target Implementation Date: 31 August 2014.</p>
<p>The Department for Economy, Science and Transport should amend the governance arrangements for the appraisal of business finance applications to enable (on an exceptional basis) urgent consideration by the Investment Panel or WIDAB.</p>	<p>Accepted The process for fast track applications is being documented in guidance. Target Implementation Date: Immediate.</p>
<p>The Department for Economy, Science and Transport should ensure that there is comprehensive record keeping to support consideration of investment cases by officials and WIDAB and the alignment of Repayable Business Finance applications with scheme criteria.</p>	<p>Accepted Current practice in this area will be enhanced. Target Implementation Date: 31 July 2014.</p>

Recommendation	Management Response
<p>FW procurement procedures should be reviewed and amended where necessary to reflect the following:</p> <p>the need to maintain a comprehensive documented record to support the assessment process and key decisions taken in the delivery of procurement exercise;</p> <p>all tenders received should be evaluated against pre-evaluation criteria (where used), before proceeding to a full evaluation;</p> <p>for all contracts procured where Financial Conduct Authority accreditation is required, this should be a mandatory condition of tender unless this is seen as a restrictive practice under EU procurement regulations;</p> <p>all due diligence work should be carried out prior to contract award and should be based on up-to-date information; and</p> <p>where financial assumptions are provided in the ITT, all tenders should be evaluated against them to ensure consistency.</p>	<p>Accepted</p> <p>This will form the substance of the lessons learnt meeting. Arthurian have been requested to provide evidence of payments under the set up costs.</p> <p>Target Implementation Date: 31 July 2014.</p>
<p>FW should obtain evidence of payments by Arthurian and its supporting invoices (or equivalent) to support the establishment costs incurred by Arthurian and recover any excess amount paid.</p>	<p>Accepted</p> <p>Arthurian have been requested to provide evidence of payments under the set-up costs.</p> <p>Target Implementation Date: 31 July 2014.</p>
<p>In future, FW should clearly document the method and rationale to be used for calculating Fund Management Fees where the Fund Management function has been outsourced.</p>	<p>Accepted</p> <p>This will be made explicit in all future invitations to tender.</p> <p>Target Implementation Date:</p> <p>No specific date can be included here as it will apply to any future tender, dates of which currently unknown.</p>

Appendix 3 - Welsh Government 'Lessons Learned' Report and Actions Taken (January 2015)

Lesson	Action taken
Conflicts of interest	
<p>1. As soon as somebody undertaking a role for or on behalf of the Welsh Government becomes a bidder to provide goods or services to the Welsh Government then this must be notified and their position reviewed and managed in line with Welsh Government policy. This may involve either ceasing their Welsh Government role or putting in place robust processes to manage the situation.</p>	<p>Note issued within Sectors and Business Area by Director, Sectors and Business requires appropriate mitigation to be put in place in such situations.</p>
<p>2. Sector Panel members should declare conflicts of interest as they arise and at each Sector Panel meeting.</p>	<p>Heads of Sector have been issued with an instruction by Director, Sectors and Business to have 'conflicts of interest' as the lead item on every panel meeting.</p>
<p>3. Sector Panel Secretariats should provide guidance to Panel members as to what constitutes a conflict of interest.</p>	<p>Guidance has been produced by Senior Corporate Governance manager and issued to members of Sector Panels.</p>
<p>4. The results and mitigations of declarations of interest received should be recorded in Panel meetings.</p>	<p>It is the responsibility of Heads of Sector to ensure this is done at each meeting.</p>
<p>5. Where a conflict of interest has been declared we should ensure that if any contact is made by the person who has declared the conflict with a relevant Welsh Government official then the nature of that contact is documented and how the conflict was managed; also that appropriate records of meetings that may be perceived as related to the disclosure are maintained to demonstrate that conflicts of interest are appropriately managed.</p>	<p>Note issued within Sectors and Business by Director, Sectors and Business.</p>
<p>6. If any further disclosures are received from Arthurian Life Sciences by Welsh Government then these should be relayed to Finance Wales as required.</p>	<p>This will only be relevant to the Head of Life Sciences Sector and has already been actioned on one occasion.</p>

Lesson	Action taken
Conflicts of interest	
7. The Department needs to develop guidance to establish clarity in Nolan Principles in the area of overlap regarding public appointees and commercial interests and this may also involve expectations regarding ethical behaviour in relation to external contractors.	Action for Senior Corporate Governance Manager in conjunction with Director of Governance Being taken forward through Corporate Governance Committee. Initial paper produced for meeting 21 October 2014. Director, Sectors and Business has referred to this in note issued to Heads of Sector.
8. Any desk instructions need to take account of both actual and potential conflicts of interest.	The issue of 'any possible' conflict of interest has been covered in the note issued by the Director, Sectors and Business. Specific reference to perception of conflict made in note issued by Senior Corporate Governance Manager to Sector Panel members. Potential conflict also covered by definition in context of consideration of offers received.
9. Improvements should be made to the handover arrangements of projects and associated issues.	This has been covered in the note issued by Director, Sectors and Business.
Governance of financial assistance schemes	
10. The processes regarding the appraisals and offers of financial support to companies must be fully documented so that an effective management and audit trail covers each investment case considered by management and WIDAB.	It is the responsibility of Heads of Sector to make their teams aware of these processes. The subject has been covered in the note from the Director Sectors and Business.
11. We need to amend the governance arrangements regarding approval of business finance applications to reflect arrangements in urgent cases.	This has been done by the Head of Due Diligence and Monitoring.
12. There needs to be clarity around the issue of in principle letters, in terms of who needs to approve these.	Head of Monitoring and Due Diligence has produced revised operating principles for the Financial Approval process which outlines the process for offers in principle.

Lesson	Action taken
Governance of financial assistance schemes	
13. Any in principle letters should have expiry dates.	Currently working on template letters which will include reference to expiry dates.
Internal processes	
14. Ensure clarity on the response given to any departure authorisations requested.	Responsibility of all staff. Covered in note issued by Director Sectors and Business.
15. We need to ensure improvements in project management in terms of making payments for services purchased, in terms of checking prior to payment that those services have been received.	Covered in note issued by Director, Sectors and Business.
16. Contract performance should be monitored in all cases.	Covered in note issued by Director, Sectors and Business.
Finance Wales	
17. Finance Wales are to conduct an independent lessons learned exercise arising from aspects of the report which directly affect that organisation.	Finance Wales Internal Auditors (Mazars) have completed a review of Procurement processes within Finance Wales to identify where further improvements could be made.

Appendix 4 - Finance Wales Internal Audit Report (relevant extracts)

In October 2014, Finance Wales received a report from its own internal auditors, setting out the results of a review of procurement arrangements for several projects (including the procurement of the fund manager for the Fund) that had been undertaken at the request of Finance Wales management.

The internal auditors had been asked to identify where further improvements in procurement processes could be made, in addition to the recommendations of the Welsh Government's Internal Audit Service (WGIAS) ([Appendix 2](#) refers) and of the Wales Audit Office (WAO).

The internal auditors concluded: 'that [a rating of] **partial assurance**²⁹ can be given to the adequacy of the control environment and that **partial assurance** can be given to the application of controls in relation to the risk areas examined in our review of procurement processes'.

The following extracts from the internal audit report (which covered the period from contract notice to contract award) are relevant to the procurement of the Fund Manager:

- Finance Wales had established a procurement panel which had relevant skills and expertise...for the Wales Life Sciences Investment Fund, external assistance was sought to ensure appropriate experience of life sciences investment was available on the panel.
- An area for improvement identified in the WGIAS and WAO draft reports was the need to document and record clearly all decisions made. This point was raised particularly in the context of the Wales Life Sciences Investment Fund, where the decision to progress with Arthurian despite not complying with the requirements of the ITT, was not formally recorded. We noted that such lessons appear to have been applied in the context of [other Finance Wales procurements].
- An area of improvement identified by the WGIAS and the WAO was the need to ensure bidders complied with tendering requirements. For example, in the Wales Life Sciences Investment Fund the winning bidder, Arthurian, was not able to comply with the requirements for audited accounts as it was set up as a Special Purpose Vehicle with the purpose of bidding for the fund. We noted that a similar situation occurred for [another Finance Wales procurement] although, in this case, it did not relate to the winning bidder. Furthermore, we were unable to obtain evidence to verify whether tender specifications and requirements had been reviewed either internally or externally prior to the procurement exercise that could have prevented these situations from arising.
- Finance Wales defines a scoring mechanism prior to procurement exercises based on a mix of cost and quality. We sought to ensure that scoring and evaluation of tenders was therefore undertaken in line with the established scoring mechanisms. We identified a number of exceptions in the application of this control, including:
 - a There were arithmetical errors in [the procurement exercise], meaning incorrect final scores were given and communicated to the bidder, although these would not have been substantial enough to affect the final outcome;

²⁹ The internal audit firm uses a three-point assurance scale in its report to Finance Wales: 'Limited' – 'Partial' – 'Substantial'.

- b Inconsistency in the approach undertaken to scoring by panel members in [the procurement exercise], with some panel members giving a score and reasons for the score, and other panel members just noting a score; and
- c Final tender scores not moderated and documented for [the procurement exercise].

Where we did note anomalies within the scoring mechanism applied, we assessed the impact on the overall outcome of the procurement exercise and are pleased to note that the awarding of the contract would not have altered.

Recommendation	Management Response
<p>Finance Wales should ensure that specifications and tender requirements are thoroughly reviewed either internally or externally prior to proceeding with procurement exercises. In particular, Finance Wales should ensure that the requirements are not restrictive but at the same time provide suitable security against supplier failure.</p>	<p>We note the comments and, in addition to taking legal advice when required, we will undertake enhanced internal challenge to ensure that the point around balancing restrictions and security is managed.</p>
<p>As noted in the WGIAS and WAO draft report, Finance Wales should ensure that compliance with tender requirements is checked prior to undertaking evaluation. Where compliance cannot be demonstrated for acceptable reasons, decisions taken should be clearly documented.</p>	<p>We will ensure that a documented trail exists covering all decision points during the process.</p>
<p>Finance Wales should ensure that evaluations are undertaken consistently across all panel members. This should include reasons for the scores given to assist in moderating disparate scores, and ensuring that appropriate evidence of the scores given and decisions made is retained on file.</p> <p>Finance Wales should ensure that arithmetical checks are performed on tender scoring, in order to ensure that tender scores communicated to successful and unsuccessful bidders are accurate. Alternatively, Finance Wales could consider setting up a model that requires less manual input.</p>	<p>We note the comments and agree to review our process for evaluating tenders. This will be in the form of a file checklist which will be put in place asap. As a further check, we will request a member of the Finance team reviews the evaluation matrices before sending to the evaluation panel for completion.</p> <p>See above.</p>
<p>Finance Wales should consider conducting formal 'lessons learnt' exercises after the completion of significant procurement activity in order to review and improve processes.</p>	<p>The comments are noted and a lessons learnt exercise will be built into the revised procurement policy and process. A report following each procurement exercise will also be a mandatory requirement once the new EU Directives have been transposed into UK law early in 2015.</p>

Appendix 5 - Audit Methods

The scope of our work

In September 2013, the Chair of the Public Accounts Committee informed the Auditor General that he had been contacted by a member of the public who had expressed concerns regarding recent investments in a company (ReNeuron Plc) by the Fund and the Chair of the Fund, Sir Christopher Evans, who had a (fully disclosed) pre-existing financial interest in that company and who is a member of its board.

The Auditor General made some preliminary enquiries into this matter and decided in October 2013 to widen the scope of his initial review into a full study that would examine the establishment of the Fund by the Welsh Government and Finance Wales, the associated governance arrangements and their oversight of its initial operations.

Also in October 2013, in response to media coverage of the Fund's operations, the Permanent Secretary of the Welsh Government decided to commission a review of certain aspects of the Fund by his Internal Audit Service (IAS). To avoid duplication of audit activity as far as possible, the Auditor General decided to dovetail his audit fieldwork with that of the IAS team, who shared their audit findings and report with staff of the Wales Audit Office. As a result of this collaborative approach to fieldwork:

- IAS initially examined the Welsh Government's actions;
- IAS and staff of the Wales Audit Office jointly examined the actions of Finance Wales; and
- Wales Audit Office staff examined the actions of the Fund Manager.

The conduct of our work

Our audit fieldwork comprised:

- document and file reviews;
- literature reviews and company searches;
- interviews and meetings (both face to face and by telephone) with relevant officials within both the Welsh Government and Finance Wales, and with the Chief Executive of the Fund Manager;
- exchanges of correspondence with various parties and their legal representatives;
- analyses of financial information;
- reviews of the findings and reports of IAS and also a report by the Finance Wales internal audit team; and
- consideration of the results of expert input commissioned by the Auditor General from Grant Thornton UK LLP on specific aspects of the Fund's investment activities and on the arrangement fees charged by the Fund Manager for the Fund's first two investments.

Review of documentation

We reviewed a wide range of documents held by the Welsh Government and Finance Wales relating to the establishment, governance and oversight of the Fund. Much of this documentation was provided directly to Wales Audit Office staff by the relevant officials, and we cannot be certain that we have reviewed all of the documentation relevant to the Fund and to the scope of our review.

We also reviewed files and papers held by IAS as a result of its audit review and report, together with documentation generated by the Fund's first and second investments.

Review of Companies House records

We reviewed relevant Companies House records, mainly with regard to Finance Wales's procurement of a Fund Manager. We also did so in respect of the Fund's first four investments, with particular regard to the Directors of each investee company.

Draft report clearance

We followed our usual 'clearance' process whereby we provide the opportunity to comment and seek confirmation from all organisations and individuals referred to in our report that:

- the facts in the report are accurately stated;
- all material facts are included; and
- the facts are fairly presented.

It is important to note that only the 'facts' within the report are 'cleared' in this way; the conclusions and recommendations contained in the report remain those of the Auditor General.

Wales Audit Office

24 Cathedral Road

Cardiff CF11 9LJ

Tel: 029 2032 0500

Fax: 029 2032 0600

Textphone: 029 2032 0660

E-mail: info@audit.wales

Website: www.audit.wales

Swyddfa Archwilio Cymru

24 Heol y Gadeirlan

Caerdydd CF11 9LJ

Ffôn: 029 2032 0500

Ffacs: 029 2032 0600

Ffôn Testun: 029 2032 0660

E-bost: info@archwilio.cymru

Gwefan: www.archwilio.cymru