

REVIEW OF WEST MIDLANDS 2000-06 ERDF PROJECT

CONTRACTED TO

STOKE CITY COUNCIL

BUSINESS GROWTH IN NORTH STAFFORDSHIRE

11 October 2012

Department for Communities & Local Government

Internal Audit Services

Contents

1	Introduction.....	2
2	Background.....	3
3	Executive Summary.....	4
4	Methodology.....	6
5	Main Findings.....	7
5.1	Excelsior Works.....	7
5.2	Just Mugs - Demolition Works – False Invoice.....	9
5.3	Just Mugs - Increased Professional Fees.....	9
5.4	Just Mugs - Potential false Building Certificate.....	10
5.5	Bridgewater Potteries.....	12
5.6	[REDACTED].....	13
5.7	[REDACTED].....	14
5.8	[REDACTED].....	15
5.9	SCC Salaries.....	16

1 Introduction

- 1.1 Internal Audit Services (IAS) was approached in October 2011 by the ERDF Closure Team (DCLG) to provide advice in relation to a Stoke City Council (SCC) ERDF Project – Business Growth in North Staffordshire (BGNS). The Project received funding from the West Midlands 2000-2006 ERDF Programme which was managed by Government Office for West Midlands (GOWM).
- 1.2 In July 2011 SCC advised DCLG that there were concerns over the timing of defrayment of expenditure relating to BGNS Core Project. The reporting of this issue by SCC was as a result of an allegation made to Staffordshire Police by a [REDACTED]. Following meetings with SCC and Staffordshire Police the Department commissioned IAS to conduct an investigation into the allegation and ascertain whether there is any ineligible expenditure claimed by the Project.

2 Background

- 2.1 The aim of the BGNS Project was to complement the Renew Housing Market Pathfinder that is remodelling and revitalising the housing around the North Staffordshire Urban Core. The intention was to provide modern and affordable premises for businesses that needed to be relocated as part of the Pathfinder. SCC are the Project Applicant but the Project was managed and delivered by RENEW North Staffordshire, the development arm of SCC.
- 2.2 The Project start date was 26 March 2007 and its practical and financial completion date was 30 Dec 2008: this date is key as it is also the final date for eligibility of expenditure throughout the 2000-06 programme. The total Project value was approximately £16.5 million with £4.2m of this being ERDF grant which consisted of both capital and revenue expenditure (see Table 1). The Project was made up of three capital sub-projects and a business relocation grant scheme. The three sub-projects are known as Just Mugs, Excelsior Works and Bridgewater Potteries with the first two being the subject of the initial allegations.

Table 1 – Breakdown of Project Expenditure

Programme Element	Total Value £	Match £	ERDF £
Just Mugs	7,985,825	6,145,609	1,840,216
Excelsior Works	4,112,807	3,132,039	980,768
Bridgewater Potteries	3,233,377	2,445,569	787,808
Business Relocation Grants	1,100,259	550,129	550,130
Consultancy Advice	102,555	51,278	51,277
Marketing	85,420	42,710	42,710
Salaries	39,610	19,805	19,805
Totals:	16,659,853	12,387,139	4,272,714

- 2.3 The allegations on procurement activity were made by a whistleblower [REDACTED]
[REDACTED] they decided to take the matter further by reporting their concerns to Staffordshire Police.
- 2.4 IAS joined with DCLG colleagues for a meeting with SCC on 30th November 2011 and Staffordshire police on 1st December 2011. SCC initially attempted to play down the significance of the allegation stating that the amounts involved were low and the expenditure was eventually used for delivery of the Project. However, in the subsequent meeting with Staffordshire police, they accepted that the issues were more serious in nature and were part of a wider investigation being conducted into the activities of the regeneration department of SCC.
- 2.5 The subsequent police investigation into the allegations found evidence to suggest:
- £100,000 of ERDF has been paid to SCC on falsified tender documentation relating to the [REDACTED] for the Excelsior sub-project.
 - £530,000 has been paid to SCC on a falsified invoice issued by [REDACTED] to the Just Mugs sub-project and evidence to show the same amount being held in an escrow account by [REDACTED] on behalf of RENEW.
 - The final building certificate for Just Mugs was raised in December 2008, before the works were fully completed.
- 2.6 We understand that [REDACTED] admitted to the first two points above but maintained that they were acting solely on instructions from their client, RENEW North Staffordshire, the development arm of SCC. RENEW were a delivery partner for this Project and individuals working for RENEW have been implicated in the police investigation.

3 Executive Summary

- 3.1 After our review of the project files for the ten remaining projects delivered by SCC as part of the 2000-06 ERDF programme we are confident that they do not show any links with the BGNS project. We have found no reason to declare the expenditure ineligible therefore we consider these to be low risk and have concentrated our efforts on the BGNS Project.
- 3.2 We have identified the evidence to confirm the initial findings reported to us by the police in relation to the Just Mugs and Excelsior sub-projects as well as other issues of a similar nature. In summary these are:

- Excelsior Works - Procurement documents were falsified in order to increase the cost of a [REDACTED]. In addition to this the contractor was asked to produce an invoice for the completed works in December 2008 despite the works not being completed until around February 2009 (see section 5.1).
- Just Mugs – A false invoice was produced by [REDACTED] for demolition works which were not part of the procured contract. This also resulted in an artificial increase to the cost of the original contract of which the [REDACTED] was charging a percentage fee. There is a high risk that the final building certificate was produced for work not fully completed (see sections 5.2 to 5.4). If neither SCC nor the contractors are able to provide evidence that this work was completed by the due date then this expenditure (£1,548,235) should also be considered ineligible.
- Bridgewater Potteries – a building certificate which has been produced following similar patterns as those identified in the Just Mugs Project (see section 5.5). Again we have asked for evidence that this work was completed by the due date, if this is not provided then the expenditure (£444,158) should also be considered ineligible.
- [REDACTED] working for the Project has stated that [REDACTED] was employed as a result of a meeting with a renew representative and without undergoing a competitive tender exercise (see section 5.6). We have seen no evidence to suggest that a competitive tender exercise was conducted.
- [REDACTED] who has stated that they have no recollection of undertaking a competitive tender exercise when being given the work (see section 5.7). We have seen no evidence to suggest that a competitive tender exercise was conducted.
- [REDACTED] – This organisation is linked to [REDACTED] who are subject to a police investigation into alleged procurement irregularities at SCC. There was no evidence on SCCs files to show that any procurement process was undertaken when appointing [REDACTED] to carry out work on the Project (see section 5.8).
- SCC Salaries – We have identified the cost of salaries relating to the two members of staff implicated in the Excelsior Works and Just Mugs fraudulent acts (see section 5.9).

3.3 As a result of the police investigation there is evidence to suggest that, on the balance of probabilities, fraudulent activity has occurred in relation to the Excelsior Works procurement and the Just Mugs [REDACTED] works. As a result of our work, we have confirmed the police findings as well as raised further concerns (above) which question eligibility of some of the expenditure within the Project.

- 3.4 In addition to this we identified a letter dated 3rd September 2008 from Government Office West Midlands (GOWM) to SCC raising concerns over the delivery and timing of the Just Mugs (College Road); Bridgewater Potteries and Excelsior Works projects. The letter also emphasised that all expenditure must be defrayed by 31st December 2008 and activity completed in order for it to be eligible for ERDF support. We were unable to locate any response to this letter.

Conclusion

- 3.5 There have been serious systemic failings in the management of this project by the City Council. In addition to the alleged fraud committed by the applicant, this report notes a number of procurement failings identified by our work. There are strong grounds for full recovery of the £4,272,714 ERDF grant.
- 3.6 However, as the Applicant has delivered the required outputs of the Project and some of the revenue expenditure appears unaffected by the issues identified, we recommend the following option to the Department:

Based on the evidence of potential fraudulent activity and systemic procurement failings we recommend that a 100% correction is applied to all expenditure relating to a procured contract (£4,253,589 which equates to £1,001,295 ERDF grant). We also recommend that the Department recovers the costs to Internal Audit Services of investigating this case (currently £20,145).

4 Methodology

- 4.1 IAS agreed to carry out an investigation in order to establish the extent of the irregularities within the BGNS Project. IAS has aimed to provide an assurance, or otherwise, that the expenditure claimed within the BGNS project, fully complies with ERDF funding requirements by:
- Reviewing the BGNS Project in order to assess the full extent of the irregularities identified through the police investigation.
 - Identifying whether the remaining sub projects within the BGNS Project show the same irregularity trends as those identified by the police in either the Excelsior or Just Mugs sub projects.
 - identifying whether Renew North Staffordshire were involved in delivering any of the other 10 projects from the 2000-2006 ERDF programme which were delivered by SCC in order to identify any further potential risks to DCLG (see table 2 for details).

Table 2 – Stoke City Council ERDF Projects 2000-06

Priority/ Measure	Project Ref	Project Name	Total Project Value £	ERDF £
1.M1.01	2084	Hot house Phase 2 The Annexe	1,103,679	342,881
1.1.02	80368	Construction Supply Chain Readiness	224,844	78,694
1.1.10	2084	Hot house Phase 2 The Annexe	473,004	146,949
2.2.1	10355	Chatterley Whitfield SME Facility	299,521	116,937
2.2.1	10360	Chatterley Whitfield SME & CTO Facility	7,304,627	2,900,065
2.2.1	20334	Burslem Regeneration Package Phase 1	1,704,278	487,364
2.2.1	20412	Greening for Growth - Phase 1	20,339,617	5,519,488
2.2.1	20412T	Greening for Growth - Phase 1	478,955	154,652.77
2.2.1	20420	City Centre Public Realm Phase 3	1,188,825	594,411
2.2.1	20328T	Package Administration/Partnership Co- ordination	21,437	10,718
2.2.1	20334	Burslem Regeneration Package Phase 1	193,255	84,983

- 4.2 We visited SCC on 19, 20, 22 and 23 March in order to review the project files for all projects. For the 10 projects we looked for similar links in relation to the type of activity, financial completion dates, and names of people and contractors involved.
- 4.3 For the BGNS Project we focussed primarily on the procurement processes undertaken for the three sub-projects that make up the BGNS whilst also looking for potential risks within the revenue element of the project. We took copies of information relating to the procurement processes for all three sub-projects as well as contact details for other suppliers relating to the revenue expenditure.
- 4.4 After reviewing the paperwork we contacted the suppliers where we had identified: a) anomalies within the procurement process undertaken to appoint them or b) invoices which followed similar patterns of those identified as fraudulent by the police.

5 Main Findings

5.1 Excelsior Works

5.1.1 We have identified evidence that appears to substantiate the allegation that SCC falsified procurement documents in order to inflate the cost of a [REDACTED] contract and therefore claim ERDF grant to which they were not entitled [REDACTED]

5.1.2 The successful tender for the [REDACTED] contract on the Excelsior Works was submitted by [REDACTED]. The initial tender submitted was for £57,000 which was made up of total demolition costs of £185,000 minus credits of £128,500 [REDACTED]. This is also confirmed by the tender opening document [REDACTED] which is signed by representatives of RENEW.

(NB - Credits - These are the scrap values that a contractor will receive for recycling any materials removed as part of the demolition contract, it is normal practice to show these within the tender and deduct them from the overall price of the tender).

5.1.3 There is an email [REDACTED] from [REDACTED] clarifying the value of the tender. The email asks if the tender price of £57,000 includes the client contingency of £50,000. [REDACTED] responds [REDACTED] stating it does not and provides a fax confirming the pricing schedule (as in Para 5.1.2) but adding £50,000 for client contingencies. This takes the value of the contract to £107,000 not including the credits.

5.1.4 The tender report document produced by [REDACTED] shows the value of the tender submitted by [REDACTED] as being £185,000 plus the £50,000 for contingencies which brings the total value of the tender to £235,500. This is £128,000 higher than the original tender submitted by [REDACTED].

5.1.5 The above is confirmed in Paragraph 2.4 of the minutes of a site meeting held on 5th November 2008 [REDACTED]. This states that there is a credit of circa £127,000 in the demolition contract and that [REDACTED] had agreed to repay this to SCC in January 2009.

5.1.6 The final cost of the demolition works was £258,900 (£297,735 including VAT). There is an invoice on file [REDACTED] from [REDACTED] dated 15 December 2008 for this amount and this is also supported by a payment certificate from [REDACTED]. The payment certificate shows the contract sum as being £235,500 and the total and the final amount to be paid as being £258,000 excluding VAT. There is no reason given as to why the final amount payable is higher than the contract sum.

5.1.7 There is a handwritten note and additional works reconciliation on file [REDACTED] which seems to be an attempt to explain the reasons for the increase in the contract value. Both the note and reconciliation are unsigned and undated; both refer to the extra security required at the site as a result of vandalism by gypsies.

5.1.8 During our interview with [REDACTED] we put these issues to him and his response was:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

5.2 Just Mugs - Demolition Works – False Invoice

5.2.1 We have identified evidence to support the allegation that [REDACTED] produced a false invoice for the amount of £461,264 (£530,453 Inc VAT) which was subsequently held in an escrow account on behalf of SCC.

5.2.2 The invoice [REDACTED] contains the same reference number (SP2128) as used on the building certificates (also produced by [REDACTED] for the main Just Mugs works contract. This contract was awarded to [REDACTED], through a tender process, with the original tender price being £1,985,997. This matches the contract sum stated on the building certificates. We identified six building certificates for this contract (although the sixth does not say final) and all of them state the contract price as £1,985,997 [REDACTED]

5.2.3 The tender report (produced by [REDACTED]) states that the contract price does not include the cost of demolishing the Washington works (see page 7 of the Just Mugs tender report [REDACTED]). However, the narrative on the invoice states “in respect of procurement and delivery services for the demolition of Washington Works, College Road.” The payment account number on the invoice has a line through it and written underneath are the words “see attached letter.”

5.2.4 We have not attempted to obtain a copy of this letter or discuss this with [REDACTED] due to their involvement in the police investigation. However, we have been informed [REDACTED] that [REDACTED] have admitted to producing the invoice stating that it was done on instructions from the client, a representative from RENEW, acting on behalf of SCC. As a result of this we consider the invoice to be potentially fraudulent and ineligible for ERDF support.

5.3 Just Mugs - Increased Professional Fees

Table 3 – Just Mugs Building Certificates

Valuation date	Issue date	Certificate Value	Balance to pay
30/06/2008	07/07/2008	67,262	67,262
05/08/2008	12/08/2008	106,644	39,382
03/09/2008	09/09/2008	229,499	122,855
10/10/2008	16/10/2008	420,518	191,018
05/11/2008	10/11/2008	572,764	152,246
11/12/2008	11/12/2008	2,121,000	1,548,235

5.4.3 All of the above issues raise concerns of the validity of this certificate particularly given that [REDACTED], who were responsible for the valuations and issuing of the certificates, have already been implicated in relation to sections 5.1 and 5.2 above. For these reasons we arranged a meeting with [REDACTED] who were the main works contractor.

5.4.4 We first contacted [REDACTED] in writing 12 April 2012, this was followed up with numerous phone calls and we finally managed to meet with a Director of the company on 12 September 2012. During the meeting we stressed that [REDACTED] were not being investigated but rather we would value their assistance in helping us with our enquiries, the following questions were put to the Director:

1. Can you provide us with details of when the works on the Just Mugs contract were completed?
2. Can you explain why building certificate has the same valuation and issue date and if the value of the certificate was correct?
3. As the building certificates were supported by invoices from [REDACTED], where you asked to produce invoices for works not fully completed?

5.4.5 The Director provided the following responses to our questions:

[REDACTED]

[REDACTED]

[REDACTED]

5.4.6 During our discussions the Director also offered the following observations:

[REDACTED]

[REDACTED]

5.4.7 In our opinion there remains a high risk that building certificate 6 contains expenditure for works which were not completed at the time the certificate was raised and unless [REDACTED] or SCC are able to provide documentary evidence to the contrary then this expenditure should be considered ineligible.

5.5 Bridgewater Potteries

5.5.1 During our review of the Bridgewater Potteries file we identified a building certificate [REDACTED] that displayed similar patterns to the one identified at 5.4 above. We identified two certificates in total with No 2 being valued and issued on the same date (see table 4) and both off these certificates add up to the full value of the contract including VAT [REDACTED]

Table 4 – Bridgewater Potteries Building Certificates

Valuation date	Issue date	Certificate Value	Balance to pay
11/11/2008	18/11/2008	257,841.36	257,841.36
12/12/2008	12/12/2008	702,000.00	444,158.64

5.5.2 There are copies of site meetings on file titled ‘Progress Meetings’ [REDACTED] and Progress Meeting No 4 was held on 17 December 2008 states at section 4.1 [REDACTED] confirmed that the majority of works were now complete however due to decanting stock into completed areas some decoration works would run into the 1st week of January”.

5.5.3 This indicates that not all of the works were completed before the certificate was raised and for these reasons we asked the question of [REDACTED] when we met to discuss the Just Mugs issues. The Director said [REDACTED]



5.5.4 In our opinion there still remains a risk that building certificate 2 contains expenditure for works which were not completed at the time the certificate was raised, although we would also say that this seems a much lower risk than with Just Mugs. However, unless [REDACTED] or SCC is able to provide documentary evidence to the contrary then this expenditure should be considered ineligible.

5.6 [REDACTED]

5.6.1 We have seen no evidence that indicates this contract was procured in line with ERDF requirements and believe that subsequently attempts have been made to conceal this [REDACTED] is a self employed [REDACTED] who was responsible for dealing with the relocation grant element of the BGNS Project. [REDACTED] role was to act as a liaison between SCC and businesses ensuring that the latter were given help and advice in applying for relocation grants from SCC.

5.6.2 There is an internal SCC exemption certificate [REDACTED] on file for this contract with the reference number E-177. The certificate is a request for exemption from SCC's financial rules which includes procurement. The main reason given for requiring an exemption is "continuation of work that was done under a previous contract" and [REDACTED] is named as the requesting officer with the financial implications being agreed by [REDACTED]. We are unable to make out the signature in the 'requesting Officer' box (dated 20 July 2007) but the authorisation box was signed PP [REDACTED] (dated 3 August 2007).

5.6.3 There is also a typed unsigned and undated file note [REDACTED] within the Project files, the note is titled 'Procurement Summary – [REDACTED]' and states the following:

"A full procurement exercise was carried out for this piece of work and all the tender documentation is retained by Iron Mountain. A claw down contract was issued in April 2007, due to the nature of the work involved. This was then extended in April 2008 on the same basis due to the continuation of the Reroot scheme".

We have asked SCC to search their archives in order to try and find the procurement documents mentioned in the file note; at the time of writing this report they have been unable to locate any.

5.6.4 The file note refers to a full procurement exercise being undertaken when appointing [REDACTED] whereas the exemption certificate refers to the appointment being as a result of an interview process. The dates mentioned within the file note do not correspond to the dates in the exemption certificate

and as the file note is anonymous it is possible that it was produced in order to conceal previous actions and make false claims.

5.6.5 For this reason we contacted [REDACTED] in order to discuss his role in the BGNS Project. [REDACTED]

5.6.6 As a result of the above we consider it highly likely that the exemption certificate was constructed after the event to provide justification for the absence of a procurement exercise for the contract. We also believe the subsequent file note was produced in an attempt to conceal the fact that no competitive tender exercise was carried out. For these reasons we consider that all expenditure relating to the [REDACTED] contract should be considered ineligible.

5.7 [REDACTED]

5.7.1 We have seen no evidence that indicates this contract was procured in line with ERDF requirements and we believe that subsequently attempts have been made to conceal this [REDACTED] similar to the contract above. [REDACTED] were contracted to provide marketing services for the BGNS Project with their first invoice appearing in claim 3 dated June 2008.

5.7.2 There is an internal SCC exemption certificate [REDACTED] on file for this contract with the reference number E- 421 similar to the one used for the [REDACTED] contract. The main reason given for requiring the exemption was “continuation of the current contract.” [REDACTED] is named as the requesting officer and there is a signature which appears to read [REDACTED] in the ‘requesting Officer’ signature box (dated 16 October 2008). There is no name in the financial implications box and the authorisation box is unsigned.

5.7.3 There is also a typed, unsigned and undated file note [REDACTED] within the Project files similar to the one used for [REDACTED]. The note is titled ‘Procurement Summary – [REDACTED] and states the following:

“A full procurement exercise was carried out for this piece of work and all the tender documentation is retained within this file. A contract was issued in May 2007 for the value of £48,986. This was then extended in October 2008 by £35,000 due to the high demand for Reroot and to also include the marketing of Excelsior Works.”

We did not identify any procurement documents in the files we reviewed therefore we have asked SCC to search their archives in order to try and find

the procurement documents relating to this contract; at the time of writing this report they have been unable to locate any.

- 5.7.4 The file note refers to a full procurement exercise being undertaken when appointing [REDACTED] and the exemption certificate refers to the continuation of a current contract. The fact that we were unable to find any procurement documents in the project files, the exemption certificate is unauthorised and the file note is anonymous, all point towards there being a high risk that both the certificate and file note were produced in order to conceal previous actions and make false claims.
- 5.7.5 We also have concerns around an invoice presented by [REDACTED] for the amount of £36,425 (£42,799 including VAT) dated 28 November 2008. [REDACTED] commenced invoicing the Project in May 2008 with the normal pattern being one invoice per month ranging from approximately £2000 to £13,135.
- 5.7.6 In November there are two invoices from [REDACTED], one for the amount of £5,100 which ties in with the invoice range and the other is for £36,425 which is considerably higher than any other invoice presented by [REDACTED]. It is also very similar to the amount of the October 2008 contract extension mentioned in the file note.
- 5.7.7 For these reasons we contacted [REDACTED] in order to discuss their role in the BGNS Project and to ask questions in relation to procurement and the invoice in question. The Director we spoke to [REDACTED]
- 5.7.8 The Director contacted us a week later saying [REDACTED]
- 5.7.9 As a result of the above we consider it highly likely that the exemption certificate was constructed after the event to provide justification for the absence of a procurement exercise for the contract. We also believe that the subsequent file note was produced in an attempt to conceal the fact that no competitive tender exercise was carried out. For these reasons we consider that all expenditure relating to the [REDACTED] contract should be considered ineligible.

5.8 [REDACTED]

- 5.8.1 We have identified several invoices totalling £18,855 raised by [REDACTED] [REDACTED] who are a subsidiary of [REDACTED] the organisation at the centre of the Staffordshire Police investigation into procurement irregularities at SCC. The investigation centred on the award of demolition contracts, to [REDACTED], by staff at SCC without undertaking a competitive tender exercise or complying with internal SCC procurement procedures. This led to 6 SCC staff being suspended and around £3 million worth of contracts being questioned.
- 5.8.2 Whilst Staffordshire Police decided there was not enough evidence to bring criminal charges, it is quite clear that the contracts awarded to [REDACTED] were not awarded in line with SCC's procurement procedures. As we were unable to find any procurement documents relating to the [REDACTED] invoices claimed through ERDF, we are of the opinion that none exist and we consider this expenditure ineligible.

5.9 SCC Salaries

- 5.9.1 We have identified various salary claims for RENEW representatives who are the two SCC staff that have been [REDACTED] as being actively involved in the potential fraudulent acts relating to Excelsior Works and Just Mugs. Their names also appear on the documents relating to the suspected fraud on the [REDACTED] contract.
- 5.9.2 These salaries equate to £7,802 and £59,210. [REDACTED] [REDACTED] have maintained all of their actions were carried out on instructions from the client who in this case was a representative of RENEW. In our opinion all salary costs relating to these staff should be considered ineligible due to their alleged involvement.